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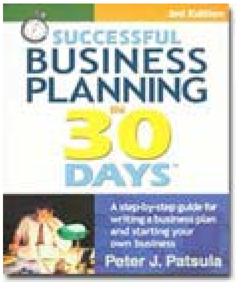

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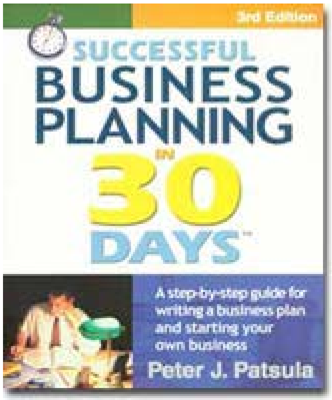

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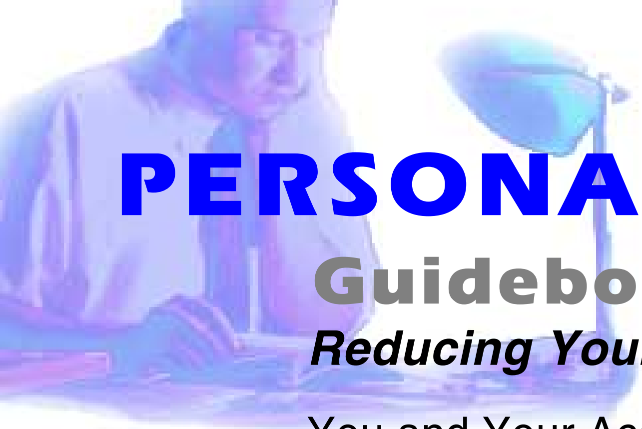
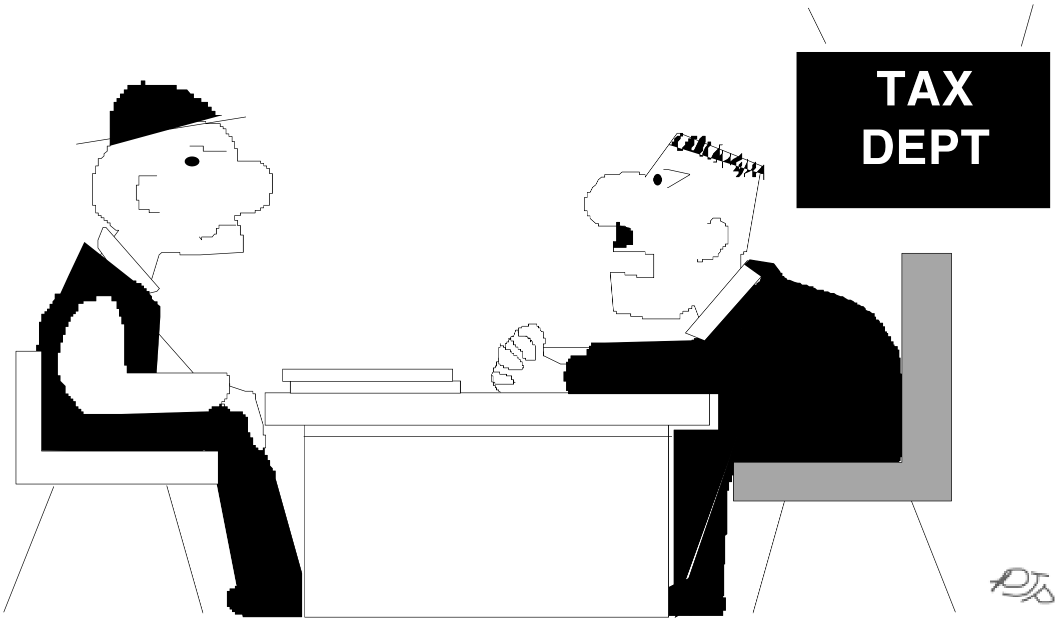


PERSONAL PLANNING

Guidebook #86:



"Quite frankly . . . it's been brought to our attention that you still have a shirt on your back."

REDUCING YOUR TAXES

THERE is a common belief that rich people don't have tax problems because they successfully spend most of their time figuring out how to avoid taxes through tax shelters and loopholes. But the fact is – come April – everybody has tax problems.

In entrepreneurial planning, the tax levy imposed by each governmental entity is the single most important impediment impacting upon your financial goals.

To make matters worse, it seems governmental agencies purposely write confusing tax laws to keep you from getting what you legally deserve. It's as if they're counting on the fact that you are too easily intimidated by the complexity of tax laws to do anything at all to reduce your tax liability. However, with knowledge and careful planning, you can legally save yourself tens of thousands, if not hundreds of thousands of dollars over your lifetime.

YOU AND YOUR ACCOUNTANT

YOUR accountant is your best friend when it comes time to doing your taxes. However, although they are essential to a good tax strategy, keep in mind that they aren't as specifically motivated as you are to save your money. Therefore, the more you know about tax strategies, tax laws and allowable tax deductions, the more you can make sure your accountant is doing a good job, and the more you can help them structure your accounts and business transactions to your advantage.

The biggest expense in your life isn't your mortgage – it's the taxman. The average business tax rate is 28 percent.
FUNFACT

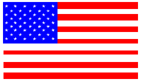
YOU AND THE INTERNAL REVENUE SERVICE

THE TAX collection agency of the United States government is a division of the Treasury Department. It employs more than 82,000 people and annually siphons off one trillion from the more than 4 trillion annual gross national income of the United States. Dozens of manuals and films on every conceivable tax problem are available, often at no charge, at local IRS field offices or in the Freedom of Information Reading Room. Some are for sale, at prices ranging from less than 5$ to more than $100.

In Mexico, the corporate income tax rate is 34%. However, dividends are not taxed.
FUNFACT

NOTE To appear before the IRS a representative for a taxpayer must be a CPA or an attorney or must ask a special examination administered through the Office of the Director of Practices.

Tax Liabilities in the U.S.



The three levels of government in the U.S. (federal, state and municipal) have distinct responsibilities and taxing authority. Some of the federal taxes for which a sole proprietor, a corporation, or a partnership may be liable are listed below. These include income tax, self-employment tax, estimated tax, social security and Medicate taxes (FICA taxes), federal unemployment (FUTA) tax and excise taxes.

NOTE The due date for individual and partnership returns is the 15th day of the

4th month after the end of the tax year. Individuals include sole proprietors, partners, and S-corporation shareholders. The due date for filing returns for corporations and S corporations is the 15th day of the 3rd month after the end of the tax year. If the 15th day of the month falls on a Saturday, Sunday, or legal holiday, the due date is the next day that is not a Saturday, Sunday, or legal holiday.

Income Tax – All businesses except partnerships must file an annual income tax return. Partnerships file an information return. Which form you use depends on how your business is organized. See the table on **page 84** to find out which return tax form you will need to file.

Corporate Tax Rates in the U.S.

Over –	But not over	Tax is:	Of the amount over –
$0	$50,000	15%	$0
50,000	75,000	$7,500 + 25%	50,000
75,000	100,000	$13,750 + 34%	75,000
100,000	335,000	$22,250 + 39%	100,000
335,000	10,000,000	$113,900 + 34%	335,000
10,000,000	15,000,000	$3,400,000 + 35%	10,000,000
15,000,000	18,333,333	$5,150,000 + 38%	15,000,000
18,333,333	–	35%	0

Source: IRS Publication 334, 1995

NOTE U.S. Personal service corporations are subject to a flat income tax rate of 35%.

NOTE Proprietorships and partnerships can deduct the same expenses as corporations from taxable income, i.e., those expenses incurred in pursuit of earning business income. Partners are taxed personally on their share of the business income of the partnership. Corporate taxable income is subject to the rates shown in the chart on the **previous page**.

Making decision about foreign operations is complex and requires an intimate knowledge of a country's commercial climate, with a realization that the climate can change overnight.
ERNST & YOUNG
International Business Series

Estimated Tax – The federal income tax is a pay-as-you-go tax. In other words, you must pay the tax as you earn or receive income during the year. This means, paying an estimated tax, if you are a sole proprietor, partner in a partnership, or a shareholder of an S-corporation. Estimated tax payments are required if the total of your estimated income tax and self-employment tax for 1996 will exceed your total withholding and credits by $500 or more. To do this use form 1040-ES (*Estimated tax for Individuals*). Corporations that expect their tax to be $500 or more must also make estimated tax payments. Installments of estimated tax must be made by the 15th day of the 4th, 6th, 9th and 12th month. Generally, each installment payment must equal 25% of the required annual estimated tax.

NOTE If a corporation or an individual fails to pay a correct installment of estimated tax in full by the due date, they may be subject to a penalty.

Self-Employment Tax – The SE tax is a social security and Medicare tax for individuals who work for themselves. It is similar to the social security and Medicare tax withheld from the pay of wage earners. It provides you with retirement benefits, disability benefits and medical insurance benefits. The self-employment tax rate on net earnings for 1996 was 15.3% or which 12.4% for social security (old-age, survivors, and disability insurance), and 2.9% for Medicare (hospital insurance). The maximum amount subject to the social security part for 1996 was $62,700. All net earnings subject to the Medicare tax.

As a U.S. Senator, I probably know more about the inner workings of the KGB than I do about the IRS.
DAVID PRYOR
Senator

Employment (FICA) Taxes – Business owners who are employers must pay employment taxes. These taxes include federal income tax withholdings, social security and Medicate taxes and Federal unemployment (FUTA) taxes.

Social Security and Medicare Taxes – Social security and medicate taxes pay for benefits the workers and their families receive under the Federal Insurance Contributions Act (FICA). Specifically, this act requires the employer and the employee to each pay 6.2% for social security tax and 1.45% for Medicare tax (1996) of the employee's income.

Federal Unemployment (FUTA) Tax – The federal unemployment tax system, along with state systems, provides unemployment payments to workers who have lost their jobs. The gross FUTA tax rate is 6.2%. The maximum amount of wages subject to FUTA tax is $7,000 (1996).

Excise Taxes – An excise tax is a tax imposed on the selling price of particular types of goods manufactured or produced in the U.S., such as gas luxury cars, coal, gasoline. Generally speaking, you may have to pay this tax if you manufacture or sell certain products, operate certain kinds of businesses or use various kinds of equipment, facilities or products (for more information on excise taxes, see Publication 510).

An excise tax is a tax that imposed on the selling price of particular types of goods manufactured or produced in the U.S. such as luxury cars, coal and gasoline.

Form 720 – *Quarterly Federal Excise Tax Return* is used for paying environmental taxes, facilities and services taxes, manufacturer's taxes on the sale or use of a variety of different products, retail sale of heavy trucks and trailers taxes, and luxury taxes on passenger cars.

Form 2290 – *Heavy Vehicle Use Tax Return* is used for paying excise taxes on trucks, truck tractors, and buses used on public highways. The tax applies to vehicles having a gross vehicle weight of 55,000 pounds or more

Form 730 – *Tax on Wagering* Form is used for paying federal excise taxes on wagering.

Form 11-C – *Occupational Tax and Registration Return for Wagering* Form is used to register any wagering activity and to pay the occupational tax on wagering.

ATF Forms – If you produce, sell, or import guns, tobacco, or alcohol products, or if you manufacture equipment for their production, you maybe liable for one or more excise taxes. Report these taxes on forms filed with the Bureaus of Alcohol, Tobacco, and Firearms (ATF).

The greater bulk of the tax burden falls upon the average citizen who never has the time to figure out how the tax system really works. ***POWERPOINT***

Alternative Minimum Tax (AMT) – The tax laws give special treatment to certain kinds of income and allow special deductions for certain kinds of expenses. So that taxpayers who benefit from these laws will pay at least a minimum amount of tax, a special tax was enacted, the "alternative minimum tax (AMT)" for corporations and individuals. The AMT rate for corporations is 20%.

Depositing Taxes – Form 8109, Federal tax Deposit Coupon, is used for depositing taxes. On each coupon, you must show the deposit amount, the type of tax, the period for which you are making a deposit, and your telephone number. Five to six weeks after you receive your employer identification number (EIN), the IRS will send you a deposit coupon book.

NOTE Generally, taxpayers whose total deposits of social security and Medicare taxes and withheld income tax during previous years exceeded certain amount are required to deposit taxes through an electronic funds transfer (EFT) system.

Tax Liabilities in Canada

The three levels of government

in Canada (federal, provincial and municipal) have distinct responsibilities and taxing authority. The federal government was given general taxing powers and levies income tax, capital tax, excise and sales tax and customs duties. The provinces were given additional taxation powers, which also allow revenue from income tax, sales tax and resource royalties, permit and licensing levies.

Some provincial responsibilities have been delegated to municipalities which levy taxes upon real estate and business, usually on the basis of the value of the property occupied and the type of business conducted.

Income taxes must be paid by all individuals and corporations resident in Canada from all sources of income received or receivable during the taxation year, less certain deductions. Individuals and branches of foreign companies doing business in Canada are liable for Canadian income tax on profits derived from their business operations here.

Unlike individuals, corporations may have a taxation year-end other than the calendar year-end.

Corporate Income Tax – Unlike individuals, corporations may have a taxation year-end other than the calendar year-end. The corporation calculates and pays its tax on the basis of this period. A corporation must pay at the end of each month of its fiscal period either one-twelfth of its estimated tax for the year or one-twelfth of the tax paid in the previous taxation year.

After the year-end, the corporation calculates its actual tax for the year and within two months of the year-end, pays any balance owing in addition to the installments, except where the small business deduction was claimed in the previous year, in which case, a three-month period is allowed.

If there is no tax owing, the corporation has up to six months after the fiscal year to file its return. Profits and losses may be offset over a seven-year period. Business losses may be carried back on year or forward five years and be deducted in computing taxable income. Tax returns for corporations must be filed both federally and provincially.

NOTE Taxation on foreign sources

How Individual Investment Returns are Taxed in CANADA (1996)

Province	Capital Gains Tax Rate %	Interest Tax Rate %	Dividend Tax Rate %	Highest Combined Federal & Provincial Marginal tax rate
NWT	28.86	38.48	23.43	44.37
Alberta	29.33	39.11	24.14	46.07
Yukon	29.84	39.78	24.23	46.55
British Columbia	30.23	40.30	24.54	54.16
Ontario	31.01	41.34	25.18	53.19
Nova Scotia	31.69	42.25	25.73	50.30
P.E.I.	31.69	42.25	25.73	50.30
New Brunswick	32.57	43.42	26.44	51.36
Manitoba	33.23	44.30	29.54	50.40
Newfoundland	33.54	44.72	27.23	51.33
Saskatchewan	34.15	45.53	29.33	51.95
Quebec	34.98	46.64	32.25	52.94
Nonresident				46.40

This chart lists the marginal tax rates (federal & provincial combined) on investment income based on an annual salary of $39,205. Marginal tax rates are the rates that would apply to each additional dollar of interest, dividend or capital gain earned.

of income or on foreign companies operating in Canada can be complicated and it is best to consult with an accountant or to contact Revenue Canada, Taxation.

Proprietorships & Partnerships Income Tax – Proprietorships and partnerships can deduct the same expenses as corporations from taxable income, i.e., those expenses incurred in pursuit of earning business income. Partners are taxed personally on their share of the business income of the partnership. Proprietors or partners must remit quarterly tax payments in advance after making allowances for approved deductions. Four installments must be made – one on March 31, June 30, September 30 and December 31. Each installment must be equal to one-quarter of either the taxpayer's estimate of his or her tax for the year or his or her tax for the previous year. The taxpayer calculates his or her actual tax for the year on or before April 30 of the following year and pays any amount he or she owes in excess of the installment or claims a refund.

Mexico has no tax on capital gains and no tax on dividends. If the U.S. doesn't get serious about capital formation, you may soon see American millionaires swimming across the Rio Grande to the land of plenty.
JAMES M. MYERS
Fortune, November 16, 1992

G.S.T. – In December of 1990, after considerable debate, the federal government passed legislation to bring the Goods and Services Tax (G.S.T.) into law. As of January 1, 1991, this broad-based, value added tax replaced the Manufacturer's Sales tax. The responsibility and obligation to both collect and remit the G.S.T. has been passed onto the business community by the federal government. As the implications which flow from this taxation process are significant, it is strongly recommended that all business owners carefully assess the impact of the G.S.T. on all aspects of their operation.

Excise Tax – Excise tax is a tax that is applied on the selling price of particular types of goods manufactured or produced in Canada such as jewelry, cigarettes, tobacco, wines and watches. Manufacturers and producers of excisable goods must operate under a manufacturer's excise tax license.

Excise tax is a tax that is applied on the selling price of particular types of goods manufactured or produced in Canada such as jewelry, cigarettes, tobacco, wines and watches.

NOTE In some cases, when a manufacturer or producer exports goods of his manufacture, excise taxes may not be payable.

Customs Duties – Although in general, importers do not need or require an import license, all imported goods are subject to customs clearance which might entail the payment of customs duties and taxes. The system is complex, with many detailed regulations governing invoicing, classification of goods, import control and documentation. You are advised to seek information from the nearest customs office.

Municipal Taxes – Property taxes are levied on the local level on the owners of businesses. There is an assessment of 65% on buildings and land based on market value in the base year of general assessment in the municipality. The amount of tax payable depends upon the mill rate of the municipality. Some municipalities also levy a local business tax. For further information regarding property taxes, contact the local municipal authority or council for the area in which you locate.

Property taxes are levied on the local level on the owners of businesses.

UNDERSTANDING THE "TAX AUDIT"

THE BANE of entrepreneurship is to receive an invitation to have your books and tax returns audited by a friendly emissary of the IRS. This invitation – better known as a **TAX AUDIT** – involves a close examination of your financial statements by the designated demigod to determine if they represent your financial position fairly and in accordance with generally accepted accounting principles.

An audit may include the physical inspection of books, financial statements, vouchers and records, as well as the gathering of evidence from third parties (such as banks).

An audit may include the physical inspection of books, financial statements, vouchers and records, as well as the gathering of evidence from third parties (such as banks). It should be noted that even though hardly more than 1% of the companies that file returns are actually audited, inquiries about discrepancies are received by far greater numbers.

It should also be noted that well-kept records can prevent most of the problems you might otherwise encounter. For example, if your records are so incomplete that your taxable income cannot be determined from them, taxation auditors will have to use other methods to establish your income. This could be time-consuming and inconvenient for you; it could also be to your disadvantage if your records do not support your claims.

NOTE Corporations are generally audited in greater numbers than proprietorships.

However, some philosophical changes, that occurred back in 1990, have allowed the IRS to expand their auditing procedures. Targeted groups experiencing increased special auditing attention include:

- dependents who show up on more that one taxpayer's return
- direct sellers such as door to door salespeople and house-party sellers
- independent contractors (including small subcontractors who work for larger construction firms)
- sellers of primary residence (who have 24 months to reinvest their proceeds)
- waiters and waitresses and other individuals who receive tips

Corporations are generally audited in greater numbers than proprietorships.

Tax Audits in Canada – In Canada, a businessman can expect to have the books and records of his or her company audited by various provincial and federal authorities. They include workers' Compensation Board; the Employment standards Branch, Revenue Canada, Source Deductions (for Unemployment Insurance, Canada Pension Plan and employee's tax contributions deducted at source); Revenue Canada, Customs and Excise (for federal sales tax) and Revenue Canada (for income tax).

What To Be Careful Of?

Categories such as entertainment and travel expenses should always be treated with caution and backed by iron-clad proof of expenditures and reasons that make sense. A manual prepared by the IRS for its staff, also lists the following *red flag* items that they look for:

- ❑ Any deviation from the norms and standards
- ❑ Asset sales without corresponding gain-and-loss schedules
- ❑ Dubious bad debts
- ❑ Expenses that are far higher than the averages for similar businesses
- ❑ Inadequate or incomplete Schedule M (reconciliation's)
- ❑ International deals and foreign tax credits

Any expense can be considered deductible from your taxable income, if it was incurred to run a business with a reasonable expectation of profit. You can further reduce your taxes by buying municipal bonds or depositing money into your company's profit sharing or stock purchase programs. ***TAXTIP***

- ❑ Investment income that was omitted in the returns
- ❑ Lack of detailed schedules in a consolidated return
- ❑ Large income from passive investments such as rents, royalties, and investments.
- ❑ Large or negative cash balances
- ❑ Large or unusual inventory changes
- ❑ Loans to and from stockholders.
- ❑ New incorporation of an established business, especially when it reports good will and accelerated depreciation

- ❑ Premature write-offs
- ❑ Starting of a last-in, first-out inventory accounting system
- ❑ Stock issued for services rendered
- ❑ Unreported interest from accounts receivable

How Long Should You Keep Your Tax Records?

You must retain books and records, other than certain documents for which there are special rules, as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep records that support an item of income or deduction on a return until the period of limitations for that return runs out. The period of limitations is the period of time in which you can amend your return to claim a credit or refund, or the IRS can assess additional tax. The period of time in which you can amend your return to claim a credit or refund is generally the later of:

The IRS has 3 years from the date you file your return to assess any additional tax. If you file a fraudulent return or no returns at all, the IRS has a longer period of time to assess additional tax. Returns filed before the due date are treated as filed on the due date.
FUNFACT

1. 3 years after the date your return is due or filed
2. 2 years after the date the tax is paid.

Practically speaking, what this means is that at a minimum you should retain all required records for at least 4 years after the date the tax becomes due or is paid, whichever is later, or about $4\frac{1}{2}$ years from the end of the last taxation year to which they relate.

However, if you fail to report income, and if that omission is more than 25% of the income shown on your return, the period of limitations does not expire until 6 years after you file your return. Furthermore, if your return is false or fraudulent, or if not return is filed, an action can generally be brought at any time (there is no limit). It is thus recommended that most documents should be kept for 7 years from the end of the last taxation year to which they relate.

Various publications of the U.S. Small Business Administration, IRS and Revenue Canada recommend keeping most tax records for at least six to seven years, even though in a number of cases you are not legally required to do so.
FUNFACT

The taxation year for a sole proprietor or partnership is the calendar year. For corporations, it is the fiscal year.

It should be noted that if you filed your return late, keep your records and supporting documents for 7 years from the date you filed that return.

It should also be noted that the minimum retention period for books and records is generally governed by the last taxation year you required a record for tax purposes, and not the year the transaction occurred or the record was created. For example, assume that you purchased some land or other business asset in 1985 and sold it in 1989. In this case, even though the records relating to the purchase of the land were created in 1985, you need them to calculate the gain or loss on the sale in 1989, and should therefore retain them for the seven-year period following 1989 (see the "How Long You Should Keep Records" chart on **page 86**).

NOTE Unless specific written permission from Revenue Canada – Taxation or the IRS is obtained, all business records and supporting documents such as sales and purchase invoices, contracts, bank statements and canceled cheques must be retained for the required time. They should be kept in an orderly manner at the place of business or designated record office (in Canada, the books must be kept until a tax and payroll audit have been completed or at least four years after the taxation year covered, and at that time, permission to destroy the record may be given). The purpose of keeping these records, among other things, is to allow the government to verify that the declarations you make on your income tax return are correct.

The purpose of keeping records, among other things, is to allow the government to verify that the declarations you make on your income tax return are correct.

MAKING THE MOST OUT OF ALLOWABLE TAX DEDUCTIONS ☑

BUSINESS EXPENSES are the ordinary and necessary expenses you incur in the operation of any business with a reasonable expectation of profit. An *ordinary* expense is one that is common and accepted in your type of business, trade or profession. A *necessary* expense is one that is helpful and appropriate for your trade, business, or profession (an expense does not have to be indispensable to be considered necessary).

In many cases making the most out of your allowable tax deductions depends more upon whether you can prove or verify that you indeed did pay for them, not whether you actually paid for them or not.

You may deduct ordinary and necessary expenses from your taxable income provided they are reasonable in the circumstances you incurred them and are not specifically limited or prohibited by tax laws.

This section will describe some of the more common expenses and other allowable tax deductions.

NOTE In many cases making the most out of your allowable tax deductions depends more upon whether you can prove or verify that you indeed did pay for them, not whether you actually paid for them or not. It is thus advisable and necessary to get a receipt for each large expenditure, as well have some sort of convenient system for keeping track of and totaling petty expenditures you incur each month (even a small, one-person enterprise can easily run up $200 a month in miscellaneous, out of pocket expenses).

Accounting & Legal Fees

Legal and accounting fees are deductible to the extent that they are incurred for the purpose of gaining or producing income from a business or property. Fees and expenses incurred for advice and assistance in preparing your tax returns are also deductible. Legal fees and other fees which you incurr to acquire capital property (such as land and buildings) are not deductible. You must include these fees as a part of the cost of the property, rather than as a direct expense for the year.

Generally, you can only deduct legal and accounting fees to the extent that they are incurred for the purpose of gaining or producing income from a business or property.

Advertising

You may deduct the cost of advertising including ads in local and national newspapers, and on local and national television and radio stations. However, in Canada you cannot deduct the cost of advertising directed primarily at a Canadian market by a foreign broadcasting company. Nor can you deduct the cost of advertising in a non-Canadian newspaper or periodical directed primarily at a Canadian market. Likewise, in the U.S., you cannot deduct the costs of advertising on foreign radio and television (including cable) where the advertising is primarily for a market in the U.S. However, this rule only applies to advertising expenses in countries that deny a deduction for advertising on a United States broadcast primarily for that country's market.

Allowable Reserves

A reserve, as it applies to taxation, is generally a deduction you may claim for an amount, which you have included in income, but will not receive until a future year. Some of the more common reserves allowed under the income tax laws include:

- reserves for doubtful debts
- reserves for goods not delivered and services not rendered
- reserves for amounts not due until a later year under an installment sales contract

Postpone or defer paying your taxes as much as you legally can.

TAX TIP

If you take a reserve in a given year under one of these provisions, you must bring it back into income in the following year. You can then take a new reserve based on your circumstances at that time.

TAX TIP *Postpone or defer paying your taxes as much as you legally can.* The first fact to recognize in planning is that the more taxation a business postpones, the more money it can retain. For example, if a business accumulates $50,000 in assets and invests it as a lump sum in a 10 percent interest-bearing instrument, in a 28 percent tax bracket, the tax is $1,400 on the $5,000 interest earned. If the interest is left in the account, the investment will grow in 10 years to $100,000 and in 20 years, it will double again to $200,000. If that same $50,000 were invested in a nontaxable bond or plan, the holder would wind up with $400,000 in 21 and a half years. Tax at 28 percent would be paid on the total gain all at one time – or less than $100,000. The holder will have more than $300,000 left rather than the $200,000 under the pay-tax-as-you-go plan.

In the U.S., the standard mileage rate for 1995 was 30 cents a mile for all business miles put on a car, van, pick-up, or panel truck.
FUNFACT

NOTE During the years since the Tax Reform Act of 1986 and its amendments, more tax deductions have been withdrawn but more opportunities exist for deferring taxes on some income.

Bad Debts

Unlike personal debts, business debts can be written off against revenues as an expense even if only partially uncollectible. There are no specific conditions that must be met before a debt may be classified as a bad debt. Such a decision should be made only after determined efforts to collect it have been unsuccessful or there is clear evidence to indicate that it has in fact become uncollectible.

However, to claim a deduction for a bad debt you must meet all of the following requirements:

a) the debt was owing to you at the end of the taxation year

b) the debt became bad during the course of the taxation year

c) you included the debt in your income

for that taxation year or a previous taxation year

Books & Business Literature

Books and business literature purchased to enhance your business education, or update or upgrade your business skills are generally tax deductible.

Business Gifts

If you give business gifts in the course of your trade or business, you can generally deduct the cost subject to certain limits and rules. In the U.S., you can deduct no more than $25 for business gifts you give directly or indirectly to any one person during your tax year. Gifts of a nominal value such as turkey, hams, or other merchandise to employees (in order to promote employee goodwill, e.g., before holidays) are also tax deductible as a business expense (these items are not considered a salary or a wage). In Canada, gifts to recognized charities are generally tax deductible.

Pay taxes on time. Avoid late penalties and interest payments. However, file your return later, not earlier. Selection for possible audits come on a first come basis; when the chosen number of audits is filled, the computer stops spitting them out. So, the later you file, the less likely you are to be audited. ***TAXTIP***

TAX TIP *Transfer investment income to other family members.* Split your investment income with children 18 or older to reduce your taxes. Income generated by the *gift investment* will then generally be taxed at the child's tax rate, which is usually lower than yours. If you are acquiring a new investment, one that you don't already own, you could simply buy the investment (shares in a business, for example) directly in your child's' name. If you already own the investment, you can transfer ownership to the child, however you are subject to the capital-gains exposure if the investment has appreciated in value.

Use your home computer, video tape recorder, cassette recorder, furniture, typewriter, or other assets, even part-time in your business. Also consider making your boat, plane, or motor home a direct part of your business. Keep in mind that repairs to any asset you use in your business can be deductible.
TAXTIP

Business Use of Your Home

You may be able to deduct the expenses for the part of your home you use for business. However, the business use of your home must meet strict requirements before any of these expenses can be taken as business deductions.

To claim a business use of your home deduction:

1. The workspace must be your principal place of business.
2. You must only use the workspace to earn income from your business and use it on a continuous and regular basis for meeting or dealing with your customers, clients or patients (you may also be able to claim this deduction if you use part of your home for the storage of inventory).

TAX TIP *Carry forward any unused por-*

tions of your "business use of home" deduction. All expenses relating to a home office or business use of a home are not deductible to the extent they exceed income from the business. In other words, you can not use home office expenses to create or increase a business loss. However generally, you can carry forward any expenses that you were unable to deduct in the present year and deduct them in the immediate subsequent taxation year (subject to the limitation of not creating a loss).

When your records are no longer needed for tax purposes, do not discard them until you check to see if you have to keep them longer for other purposes. For example, your insurance company or creditors may require you to keep them longer than the IRS does.
TAXTIP

TAX TIP *In Canada, avoid taking a CGA deduction for business use of your home.*

Canadians should be warned that taking a home business deduction for CGA (depreciation allowance) might interfere with the tax-free capital gains to which they are entitled to when their principal residence is sold for a profit. For most people, a good guideline would be to take all home office related expenses except CGA.

Capital Expenses

Unlike ordinary business expenses, which can be deducted at the end of each year, capital expenses must be deducted over a period of years through depreciation, amortization and depletion. Capital expenses generally include asset costs, start-up costs and intangible property costs etc.

Depreciation of Certain Capital Expenses – You usually recover the costs of an asset with a useful life longer than one year (e.g., office furniture, buildings, and equipment) through depreciation. Using depreciation you spread the cost of the asset over a number of years; how many years, depends on the type of asset being depreciated (depreciation is discussed in more detail later in this guidebook).

Amortization lets you recover certain capital expenses in a way that is like straight-line depreciation (generally, you deduct equal amounts of the expense over a 60 month period).

Amortization of Certain Capital Expenses – Amortization lets you recover certain capital expenses in a way that is like straight-line depreciation (generally, you deduct equal amounts of the expense over a 60 month period). Since amortization sometimes allows a write-off of expenses that are not ordinarily deductible, you may want to elect to recover your eligible expenses by taking amortization deductions. However, only certain specified expenses may be amortized for federal income tax purposes. Such expenses include but are not limited to:

- certain kinds of start-up expenses
- certain intangible expenses such as goodwill, patents, franchise rights, trademarks and copyrights
- research and experimental costs
- pollution control facilities

NOTE If you want to amortize your expenses, you usually must make an election to do so using Form 4562.

Depletion of Certain Capital Expenses – In the, U.S., if you own and have an economic interest in mineral property standing timber, or other natural resources such and oil and gas wells, you may be able to take a deduction for depletion.

Capital Gains & Losses

Capital gain and loss deductions can apply to all levels of investing and property including: stocks, bonds, partnership shares, depreciable business property, cars, machinery, buildings, personal property, boats, antiques, collections, books, art. Capital gains or losses are created only when you sell a property, not from the appreciation or depreciation while you still hold it.

Beginning in 1990, in Canada 75% of any capital gains are subject to tax.

Beginning in 1990, in **Canada** 75% of any capital gains are subject to tax. The amount is called your taxable capital gain. If your allowable capital losses are greater than the amount of your taxable capital gains in any one year, you may apply the excess losses to the three previous tax years to reduce up to 100% of the taxes on taxable capital gains for those years. On the other hand, the allowable capital loss also limited to 75% of your actual capital loss. Losses resulting from the sale of capital property can be deducted from your taxable income.

TAX TIP *If you report a taxable capital gain on your personal income tax return (for a sole-proprietorship or partnership), you* *may also be able to claim a special "capital gains deduction" to offset this gain.* There is a limit however to the total capital gains deduction that you may claim in your lifetime. Presently this limit is set at $500,000 (in Canada) for small businesses (corporations do not qualify for capital gains deductions). Small business corporation owners and farm owners are eligible for this exemption when they sell shares of their business corporation or farm.

In Canada, the personal tax free $100,000 capital gains exemption disappeared with the 1994 budget. ***FUNFACT***

NOTE To know if a certain transaction you qualifies for capital gains status ask yourself:

- Did you earn income from the property? If so, this favor capital gains status.
- Is it apparent that you main motive was not to make a quick resale profit? If so, capital-gains status may be available.
- Did you hold the property a long time?
- Is the transaction not related to you regular business?
- Do the circumstances of the sale indicate that you are not in the business of buying and selling?

TAX TIP *Determine the best time to sell or acquire an asset.* If your income for the year is on the low side of the 33 percent tax bracket, you may want to make a few large purchases before the end of the year so as to avoid paying this higher rate and drop your taxable income back into the high side of the 28 percent tax bracket (or change from the 28 percent bracket to the 15 percent bracket). Likewise if you are on the high side of the 28 percent tax bracket, don't sell an asset of considerable worth bumping you up into the higher 33 percent tax bracket.

TAX TIP *At the end of the year, sell your stock market losers.* This can help you offset capital gains at the end of the year of other stock.

If you think you are legally entitled to a deduction – take it. The worse the taxman can say is no. ***TAXTIP***

TAX TIP *If you own two businesses write off losses against the more profitable business.* If you own several separate businesses (with various situations of profit and loss), it may be more effective to control them through a partner holding company so tax losses in one business can be balanced against tax owned in another business.

TAX TIP *Invest in small companies.* Beginning in 1998 in the U.S., investments in certain small business stock held more than 5 years will qualify for a special tax benefit. If you sell or exchange the stock at a gain, only one-half of the gain will be subject to federal income tax. For information on qualifying stock, see chapter 4 of Publication 550, Investment Income and Expenses.

Car & Truck

Car, truck and other transportation expenses needed in the conduct of your business, are tax deductible. Cash expenses you may deduct include:

- AAA membership
- garage rent
- gas

- insurance
- lease fees
- license & registration fees
- oil & lubricants
- parking fees
- rental fees
- repairs & maintenance
- tires
- tolls

You can also claim depreciation expenses and interest on loans used to purchase the car or make repairs.

In the U.S. you can deduct either your actual expenses or the standard mileage rate. However, you can use the standard mileage rate only for a car that you own, not lease or rent (for 1996, the standard mileage rate was 30 cents per mile). In Canada, you must keep track of your actual expenses.

Set up a business office in your home. Buy books, subscriptions, newsletters or tape courses that relate to your particular business or business in general. ***TAXTIP***

NOTE When buying a car for business, delivery, freight charges, and sales tax are considered capital expenses and are added to the cost of the car (for information on selling your car to your business.

TAX TIP *If you use your car for both business and personal purposes, you can divide your expenses between business and personal use.* It is important to note that if you use your car only partly partly to earn business income and partly for personal purposes, you can still claim that portion of the total expenses that relates to business use. If for example you use your automobile 60% of the time for business, then 60% of the cost of running it as well as 60% of its depreciation is deductible.

However, in order to support the amount you claim, it is important to keep a record – an auto log – of how much you use the vehicle for business and how much for personal use. This logbook or other similar record should show the total miles or kilometers driven and the total miles or kilometers driven to earn business income. According to the log book example shown in the middle of this page, if expenses to run the car were $1,500 for the year then the deductible amount would be 12,000/20,000 x $1,500 = $900.

Date	km	Business	Personal
5/1/89	250	200	50
2	126	–	126
3	76	65	11
5/ 31/90	20,000	12,000	8,000

Charitable Donations

In the U.S., cash payments to charitable, religious, educational, scientific, or similar organizations may be deductible as business expenses if the payments are NOT charitable contributions or gifts (i.e., you pay $15 to a church for a half-page ad in a program for a concert they are sponsoring; in this case the deduction becomes an advertising expense).

However, corporations can deduct charitable contributions on their income tax returns. Individuals, partners in a partnership, or shareholders in as S-corporation may be able to deduct charitable contributions made by their business on their individual income tax returns. In Canada, generally speaking charitable contributions can also be deducted within limits.

The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing.
JEAN BAPTISTE COLBERT

Conventions & Business Related Functions

Attendance at conventions, conferences, trade shows, and business related functions, are deductible though subject to certain limitations. A convention can be defined as a formal meeting of members of an organization for professional or business purposes. To be deductible, it must be related to your business or profession, and held in a place consistent with the territorial scope of the business or professional organization holding the convention.

NOTE A self-employed taxpayer who is carrying on a business may deduct expenses incurred in attending not more than two conventions a year.

Cost of Goods Sold

Inventory and raw materials costs are deductible from your sales revenues for the year to arrive at your gross profit.

Costs of Removing Barriers to the Disabled and the Elderly

The cost of an improvement to a business asset is normally a capital expense.

However, you can choose to deduct your expenses for making a facility or transportation vehicle, owned or leased for use in connection with your trade or business, more accessible to and usable by those who are disabled or elderly. Such costs can be incurred making doors wide enough for wheel chair access, enlarging a toilet space, creating an access ramp, adding a nonslip surface to a floor etc.

NOTE In the U.S., the most you can deduct is $15,000.

The hardest thing in the world to understand is the income tax.
ALBERT EINSTEIN

Delivery & Freight Charges

In general, any delivery, freight or shipping charge, which you incur in the course of your business, is deductible as a business expense.

Depreciation

You cannot claim the original cost of capital additions such as equipment and buildings used to earn income in a business as an operating expense nor can you claim the original cost of substantial asset improvements to assets.

However, to recognize that over a number of years such properties will wear out or become obsolete, you may claim a portion of their cost each year as a deduction.

For property to be depreciable, it must first meet all of the following basic requirements:

1. The property must be used in business or held for the production of income.
2. The property must have a determinable useful life and that life must be longer

than one year.

3. The property must be something that wears out, decays, gets used up, becomes obsolete, or loses value from natural causes

In the U.S., the current depreciation system used for most tangible assets placed in service after 1986 is the Modified Accelerated Cost Recovery System (MACRS).

Depreciation in the U.S. – In the U.S., the current depreciation system used for most tangible assets placed in service after 1986 is the Modified Accelerated Cost Recovery System (MACRS). The main system is called the General Depreciation System **(GDS)** and applies to most property. This system divides classes of property into time periods of 3, 5, 7, 10, 15 and 20 years.

3-year Property – This class includes tractor units and race horses.

5-year Property – This class includes automobiles, buses trucks, computers and peripheral equipment, and office machinery (typewriters, calculators, copier etc.), and any property used in research and experimentation.

7-year Property – This class includes office furniture and fixtures (desks, files etc.).

10-year Property – This class includes vessels, barges, tugs, and similar water transportation equipment, as well as any single purpose agricultural or horticultural structure and any tree or vine bearing fruit or nuts.

NOTE Using the ADS method, the recover period is 15 years.

15-year Property – This class includes certain depreciable improvements made directly to land or added to it, such as shrubbery, fences, roads and bridges.

NOTE Using the ADS method, the recover period is 20 years.

20-year Property – This class includes farm buildings and any municipal sewers.

Residential Real Property – This class includes any real property that is a rental building or structure (including mobile homes). The recovery period for this property is 27.5 years.

NOTE Using the ADS method, the recover period is 40 years.

Nonresidential Real Property – This class includes any property that is not residential rental property or property with a class life of less than 27.5 years. The recovery period for this class of property is 39 years for property you placed in service after May 12, 1193, or 31.5 years for property you placed in service before May 13, 1993.

A government big enough to give us everything we want would be big enough to take from us everything we have.
GERALD FORD
U.S. President

NOTE Using the ADS method, the recover period is 40 years.

The second system used in MACRS is called the Alternative Depreciation System **(ADS)**. However, unless ADS is specifically required by law (such as any tangible property used predominantly outside the U.S. during the year) or you elect it, GDS is generally used to figure your depreciation deductions. The Major differences between GDS and ADS are the recovery period and method of depreciation you use to figure the deductions. Because GDS permits use of the declining balance method over a shorter recovery period, the deduction is greater in the earlier years.

NOTE Under MACRS you cannot depreciate intangible property, motion pictures, videotapes, and sound recordings.

Depreciation Methods – Under MACRS, there are five ways to depreciate your property.

a. *200% Declining Balance Method –* You can use this method for nonfarm property in the 3-, 5-, 7-, and 10- year class over a GDS recovery period and apply a half-year convention. Under the half-year convention, treat all property placed in service, or disposed of, during a tax year as placed in service, or disposed of, at the mid-point of that tax year. Under certain conditions, you may have to use the mid-quarter convention instead of the half-year convention (See Appendix A in Publication 946 for complete MACRS tables, including tables for the mid-quarter convention).

MACRS TABLE

Year	3-Year	5-Year	7-Year
1	33.33%	20%	14.29%
2	44.45%	32%	24.49%
3	14.81%	19.2%	17.49%
4	7.41%	11.52%	12.49%
5		11.52%	8.93%
6		5.76%	8.92%
7			9.93%
8			4.46%

b. *150% Declining Balance Method –* You can use this method for all property in farming businesses (except real property) and for all other property in the 15- and 20-year property classes. For these classes of property, you can change to the straight-line method for the first tax year if it yields a large deduction. You always use the straight-line method for residential rental and nonresidential real property.

c. *Straight Line Election –* Once made, the election to use the straight-line method cannot be changed.

d. *150% ADS Election –* Instead of using the 200% declining balance method over the GDS recovery period, you can elect to use the 150% declining balance method over the ADS recovery period. If the property does not have an ADS recovery period assigned to it, the recover period is 12 years. A half-year or mid-quarter convention is used and there is a change to the straight-line method when that method will give a larger deduction.

e. *ADS Method –* If you choose you can also use the ADS method, Under this method, depreciation is figured using the straight-line method but over ADS recovery periods. It should be noted that if you make the ADS election you can never revoke it.

Use the section 179 deduction in the U.S. the income tax act to write-off equipment immediately rather than depreciate it over a longer term.
TAXTIP

TAX TIP *Use the section 179 deduction in* *the U.S. the income tax act to write-off equipment immediately rather than depreciate it over a longer term.* As long as your business spends less than $200,000 on equipment annually, it qualifies for one of the best small-business breaks ever. The section 179 deduction in the U.S. income tax act allows immediate 100% write-offs of office furniture, equipment and other qualified fixed assets, in the year you purchase the asset for use in your business, that otherwise would be depreciable over a longer period of time (between three to seven years).

Use your automobile in your business, to create deductions through Capital Cost Allowance, gas, repairs, insurance, parking and interest. Consider selling your personal automobile to your business. ***TAXTIP***

In 1992, the ceiling on this deduction was $10,000. New tax legislation however, has bumped up the deduction to $17,500 (see Publication 946 for more specific information).

NOTE Under the write-off provision, small entrepreneurs can invest in a computerized accounting system, for instance, and use Section 179 to help reduce the after-tax costs of the system.

TAX TIP *Keep in mind the effect taxes will have on interest and depreciation.* During the early part of a business, interest and depreciation are usually high, resulting in increased expenses and, thus, decreased profits. Later, when the principal is paid down, interest is low and depreciation is close to nonexistent, you will owe higher taxes, which will result in a higher tax rate.

Depreciation in Canada – In Canada, items are depreciated on a diminishing balance basis under what is called the *capital cost allowance*. In this system, the assets which you purchase are grouped into classes which are established by Federal Tax Regulations.

- cement and brick buildings are depreciated at a rate of 4% (5%)
- frame buildings at 10%
- machinery and equipment at 20%
- automotive equipment, computers and general production equipment at 30%
- passenger vehicles at 30%
- certain contractors' equipment at 50%

Equipment purchased after May 8, 1972 to be used to manufacture goods for sale or lease in Canada can be fully depreciated in two years.

- and tools or utensils costing less than $200 as well as computer application software 100%

If you have a number of properties within a particular class, the properties of that class are treated as one unit. In the first year that you purchase an asset (applies to Canada only), you can only claim one half of the capital cost allowance available on the asset.

NOTE Equipment purchased after May 8, 1972 to be used to manufacture goods for sale or lease in Canada can be fully depreciated in two years.

TAX TIP *Use your own personal assets in your business and make them tax deductible.* Incorporating into your business your own vehicle or equipment, such as a home computer, videotape recorder, cassette recorder, calculator, tools or furniture, and even recreational assets, can make these assets deductible on a percentage basis. However, to claim full deductions you must sell the asset to your company and use it only for business purposes. Usually, the capital cost for your business will then be the fair market value (FMV) of the vehicle or asset at the time of transfer.

In this world, nothing can be said to be certain, except death and taxes.
BENJAMIN FRANKLIN

FMV is the amount that you would buy or sell the vehicle or asset for in a normal business transaction. Your tax deductions will then be computed by depreciating the market value of the personal assets sold to your business at the time they were converted to business use using the CGA decline balance method, and based on the percentage of time you used your assets for business and the Capital Cost Allowance class to which they belong.

TAX TIP *Check to see of your asset acquisitions qualify for Canada's Investment Tax Credit.* In Canada, you may qualify for a potential deduction from tax payable which is calculated as a percentage of the cost of a qualifying asset or expenditure, if you made an expenditure in one of the qualifying areas outlined in the Income Tax Act. In all cases, the property you acquire must be new. This means that is must not have been used or leased for any purposes before you acquire it.

Dividends-Received

In Canada, dividend income receives favorable treatment over interest income and capital gains under the Income Tax Act, via the Federal *dividend tax credit*. Under the dividend tax credit you can receive a tax credit on dividends earned. Because dividends are paid out of a company's after-tax income, to avoid double taxation, Revenue Canada gives you a credit, which reduces the total tax you pay (this means that your after-tax income from dividend income can be higher than from traditional fixed income investments such as GICs).

Donations to other business organizations can generally be deducted as business expenses if they relate directly to your trade or business and you reasonably expect a financial return in line with your donation.

In the U.S., a corporation can deduct a percentage of certain dividends received during its tax year using the *dividends-received deduction*. This percentage varies from nil up to 100% depending on type of stock and percentage of company stock the receiver owns. A corporation for example, can deduct, with certain limits, 80% of the dividends received or accrued if it owns 20% or more of the paying domestic corporation.

Donations to Other Business Organizations

Donations to other business organizations can generally be deducted as business expenses if they relate directly to your trade or business and you reasonably expect a financial return in line with your donation. For example, a contribution you make to a committee organized by the Chamber of Commerce to bring a national convention to your city may be deductible.

Education Fees

In Canada, tuition fees paid to educational institutions for which a tuition tax credit is allowed are tax deductible. As well, business seminars, workshops, and businesses related audio and videotape courses are also tax deductible.

Salaries and wages paid to employees, including those paid to family members are deductible as a business expense.

In the U.S., education expenses can be deducted as long as you can show the education maintains or improves skills required in your trade, business or profession, or it is required by law or regulations for keeping your pay, status, or job. You can also generally, deduct the ordinary and necessary expenses you pay for the education and training of your employees.

NOTE In the U.S., you cannot deduct education expenses you incur to meet the minimum requirements of your present trade, business, or profession, or those that qualify you for a new trade, business, or profession, even if the education maintains or improves skills presently required in your business.

Employees' Pay

Salaries and wages paid to employees, including those paid to family members are deductible as a business expense, along with the employer's share of federal pension plans and unemployment insurance premiums and other government required deductions. You can also generally deduct other forms of pay you make to employees as a business expense, including commissions, vacation pay, compensation for sickness and injury, disability or income maintenance insurance plans, compensation for moving expenses, cash bonuses (as long as the bonus was reasonable for the services performed), expense accounts, and loans or cash advances you do not expect the employee to repay (if it is for work or services already performed).

A Corporation may claim wages paid to shareholders as well as other employees.

It should also be noted that gift certificates or any similar items readily convertible to cash are considered additional wages or salaries, regardless of the amount or value. Employee achievement awards, such as length-of-service awards and safety achievement awards can also be deducted within certain limitations.

NOTE A Corporation may claim wages paid to shareholders as well as other employees.

Employee Benefit Programs – Employee benefit programs which may include life insurance, group term life insurance, medical insurance, dependent care assistance, welfare benefit fund, cafeteria plans and educational assistance generally can be deducted as expenses to your business. However, the extent of these deductions, the process of claiming a deduction for each expense, and whether the amount is includible or excludable from an employee's income, varies for each category. For more detailed information on what costs you can and cannot deduct consult the appropriate federal tax publication.

Fringe Benefits – A fringe benefit is a form of compensation provided to a person in your employ. Generally, they are deductible as employee expenses if you include in your employees' pay the value of the compensation. The compensation may include any property or services provided by the employer such as a:

- discount on property or services
- flight on a employer-provided aircraft
- free or discounted commercial airline flight
- membership in a country club or other social club
- ticket to an entertainment or sporting event
- vacation
- vehicle

You can usually deduct the cost of furnishing meals and lodging to your employees if the expense is an ordinary and necessary expense to your business.

NOTE The value of includible fringe benefits you provide is also generally subject to social security and Medicare taxes, federal unemployment tax (FUTA), and federal income tax withholding.

Meals and Lodging Furnished to Employees – You can usually deduct the cost of furnishing meals and lodging to your employees if the expense is an ordinary and necessary expense to your business. However, this cost is generally not deducted as employees' pay, but as an expense of operating your business. For example, if you rent or purchase a house for an employee you deduct the cost of insurance, utilities, rent and/or depreciation in each of those categories on your return.

It should be noted that normally, there is a 50% limit on the amount you can deduct for providing meals to your employees, unless:

- the value of the meals is includible in your employees' income
- you operate a restaurant or catering service and you furnish the meals to your employees at the work site
- you furnish the meals at a business social activity such as a company picnic
- you are required to furnish meals to crew members of a commercial vessel under federal law

Plan a trip around a business purpose, such as staff meetings, visiting customers, or suppliers, and setting up a sales organization.
TAXTIP

TAX TIP *Pay your spouse or kids a deductible salary to help with your job.* The Canadian and American Income Tax Act allows you to deduct reasonable salary expenses you pay for an assistant. The rule would allow you to hire family members and pay them a deductible salary commensurate with what you would pay a non-family member for the same service. These salaries are then treated as taxable income by your family-member employees (keep in mind that you lose the tax advantages if you pay wages to a family member in a higher tax bracket).

You may normally claim the wages you pay to your child or spouse as an expense if:

1. The family members actually do the work for which they are paid. It would not be proper to pay a family member for work not performed simply to claim a tax deduction, nor would it be proper to pay a salary for non-business work.

2. The services they provide are necessary for earning business income and would otherwise have required you to employ some other person. Spousal assistants can answer the telephone, write letters, answer correspondence, file paper, make appointments, record business activities, follow up with clients, maintain appointment logs, keep expense records, and generally assist with whatever else you do. Kids can be paid for cleaning the business office,answering the phone when you are away, stuffing and addressing envelopes, keeping track of inventory, delivering products, running business errands, and entering data on the computer.

Pay your spouse or kids a deductible salary to help with your job.
TAXTIP

3. The salary is less or the same as an amount you would have to pay a non-family member to do the same job. The pay cannot be unreasonable for the work performed. Refrain from overpaying a family member in order to claim a greater tax deduction. Minimum

wages are not unreasonable.

4. You actually pay the wages and these payments are periodic. It is very foolish to claim wages that haven't been paid. To save yourself from having this deduction scrutinized more closely, it is recommended that you pay family members by check at least once a month as you would any employee. Avoid paying by cash as this is harder to document.

NOTE It should be noted that salaries paid to children under 18 are not subject to Canada Pension Plan or American Social Security contributions. Furthermore, typically no at-source tax withholding is required if the family member is paid under $6,500 per year. It should also be noted that when you employ your spouse, life insurance premiums, tuition for job-related education and training, and business-related travel and entertainment may also become tax deductible as well. Furthermore, using this powerful strategy, your family member "assistant" now has money to invest in an IRA or RRSP of his or her own.

It should be noted that salaries paid to children under 18 are not subject to Canada Pension Plan or American Social Security contributions.

TAX TIP *Hire a family assistant to create an outright business loss.* It is possible for deductible expenses incurred when hiring a family member to result in outright business losses. If so, these losses may be deducible against other sources of income. A lower-income spouse may thus consider starting a business in which tax losses are anticipated. These tax losses may be of little or no use directly to the low-income spouse, but the higher-income spouse can take tax losses as tax deductions. That spouse can therefore profit by setting up the business under the higher-bracket spouses name. Using this strategy, the lower-income spouse would be paid a tax-deductible salary. This in effect takes the income received by the high earning spouse from his or her employment and redistributes it to the lower earner, who is taxed on the same income at a lower rate.

Environmental Clean Up Costs

You can deduct certain costs to clean up land and to treat groundwater that you contaminated with hazardous waste from your business operations.

Equipment Rentals & Leases

Generally, any expenses incurred in renting or leasing equipment for use in your business are allowable business expenses.

Office and store furnishings and fixtures are generally deductible as capital expenditures.

Furnishings & Fixtures

Office and store furnishings and fixtures are generally deductible as capital expenditures.

Health Insurance

In the U.S. you may be able to deduct 30% of the amount paid during the year for medical insurance for yourself and your family if you are self-employed, a general partner in a partnership, or a shareholder owning more than 2% of the outstanding stock of an S-corporation. You are allowed this deduction whether you paid the premiums yourself or your partnership or S-corporation paid the premiums and you included these amounts in your gross income.

Insurance

Generally, you may deduct all ordinary commercial insurance premiums on buildings, machinery and equipment you use in your business including product liability, special riders on homeowner's policies and computer insurance. You can also deduct credit insurance to cover losses from unpaid debts, group hospitalization and medical insurance costs paid for employees, car and other vehicle insurance, overhead insurance, contributions to a state unemployment insurance fund and worker's compensation insurance.

Be sure you have a sound, valid, hard-to-shake and up-to-date will. ***TAXTIP***

NOTE Incorporation allows you to deduct 100 percent of health insurance premiums (as well as dental and life). However, as a small business owner you can deduct up to 25 percent of your health insurance premiums from your taxable income.

TAX TIP *You can claim an income tax deduction for funds used for you and your employees' retirement.* If you are self-employed, you can claim an income tax deduction for funds used for you and your employees' retirement through insurance or annuities approved for use under the Employees Retirement Income Security Act of 1974 (ERISA) American Flag.

Intangible Assets

Some expenditures commonly calling *in-*

tangible assets are not deductible either as an expense or by way of the regular capital cost allowance. However, they do qualify to be written off in a manner similar to capital cost allowance, on a declining basis.

Some of the more common examples of deductible intangible assets (also known as eligible capital expenditures) are goodwill, patents, franchises, trademarks, computer software, designs and patterns, and customer lists. The portion of the expenditure which you may add to the pool of expenditures (called the cumulative eligible capital account) is 75 percent of the purchase price. You may then make a deduction, in a manner similar to capital cost allowance, which is equal to 7 percent of the amount remaining in the pool.

Tax reduction often does not result in a decreased tax obligation but transfers payment of the obligations to a future time. ***TAXTIP***

Interest

Interest is the amount you pay for the use of borrowed money. You can generally deduct all interest you pay or accrue during the tax year on debts related to your trade or business including interest on business loans, business charge cards, business bank charges, and accounts payable. This rule also applies when you borrow money to purchase an automobile, video recorder, computer or other asset for use even part-time in your business. The business interest portion (the % of interest matching the % of time the asset is used for the business), can also be deducted. However, there are four criteria, which must be met for business interest to be deductible:

- The interest must be paid or payable in the year of the claim.
- You must claim the interest according to the method you usually follow.
- You must have a legal obligation to pay interest and your creditor must have legal recourse against you (there must be documentary evidence to support this legal obligation).
- You must use the borrowed money for the purpose of earning income with the possibility and the reasonable expectation of earning income (i.e., you can't deduct interest on loans used to by buy vacant land which has no prospects of producing income).

Borrow to buy investments, when the rate or return plus the interest deduction is greater than the interest payments. ***TAXTIP***

TAX TIP *You can plan your financial affairs to take advantage of the tax benefits of the above deduction.* For example, if you are making both personal and investment purchases, and you have to borrow for one or the other, borrow to purchase the investment and pay cash for the personal asset. This strategy will allow you to claim an interest deduction on your tax return. However, be warned that you should not co-mingle funds from different accounts as this can disallow an investment-interest deduction. It is also important that the business loan be set up by the banker as separate from the mortgage, to ensure the deductibility of interest. If necessary, different banks should be used for each loan.

TAX TIP *Build up equity in the house as fast as possible.* This will allow you to eliminate in the future, the non tax-deductible real estate interest (in Canada) and replace it, wherever possible, with tax-deductible business interest.

TAX TIP *Borrow to buy investments, when the rate or return plus the interest deduction is greater than the interest payments.* Don't think of borrowing to buy the investment; think of borrowing to manufacture tax relief. For example, if interest rates are 8% and stocks are appreciating at 20%, and your tax rate is 40%, your rate of return would be 20% - 8% + (0.4 x 8%) = 15.2%. Not bad, considering it's free.

The investment that you buy with the borrowed funds must produce a regular rate of return and have a potential for capital gains, in order for its interest to be deductible.

NOTE The investment that you buy with the borrowed funds must produce a regular rate of return and have a potential for capital gains, in order for its interest to be deductible. Also, keep in mind when making such an investment decision, that the return should justify the risk. Stocks for example, could just as easily go down.

Interview Expense Allowances

Reimbursements you make to job candidates for transportation or other expenses related to interview for possible employment are not wages. They are not subject to social security and Medicare taxes (FICA), federal unemployment taxes (FUTA), or the withholding of income tax. However, you can deduct the allowances as a business expense.

Land

The purchase of land is not an allowable business expense as land is generally a capital asset with an indefinite life. Furthermore, as land is not a depreciable asset, it does not wear out or become obsolete over time, you may also not claim a deduction for depreciation. Because of this, special rules apply if you acquire a property that includes land and a building.

File separately or jointly depending on tax breaks. For married couples, figure out whether it is advantageous to file separately or jointly with a spouse.
TAXTIP

You must allocate the purchase price between the land and the building on a reasonable basis so that you can add the cost of the building to the depreciation schedule. You must also allocate any fees relating to the purchase, such as legal, accounting and engineering fees, between the land and building on the same basis in which you allocated the purchase price.

Light, Heat & Water

Expenses for utilities generated from operating your business are allowable business deductions. If however you are working out of you home, you can only deduct what is considered a *reasonable portion* of the costs that relate to the business use of your home. To calculate this *reasonable portion*, divide the area of the work space by the total area of your home.

Maintenance & Repairs

You can generally deduct the costs of maintaining and repairing business equipment and buildings from your taxable income.

However, some uncertainty can arise when the repairs involve substantial alterations to a capital asset or replacement of substantial parts of a capital asset. In this case, the costs may cease to become deductible *current expenses* and become deductible only through *capital expenditures* depreciation allowances.

In general, capital expenditures are those made by a taxpayer to acquire property, which will produce an enduring benefit. This is in contrast to expenditures of a current nature, which produce an immediate benefit but have little long-term effect.

Incorporation become increasingly desirable particularly at higher income levels, where there is a growing discrepancy between corporate tax rates (which cap out at 35 percent) and individual income tax rates (which have increases to 39.6 percent maximum).
TAXTIP

Renovations or repairs are deductible as current expenses or capital expenditures depending on whether they restore a property to its original condition, or significantly improve the property beyond its original condition. Painting a floor or roof is considered an expense, whereas installing a new floor or new roof which is of better quality and greater durability than the replaced one, should be treated as capital in nature.

It is also important to consider the relative value of the expenditure in relation to the value of the whole property, when determining whether it is current or capital in nature. For example although a spark plug in an engine may be a separate marketable asset, you would never regard the cost of replacing it as anything but a current expense. However, if you replaced the engine itself, the expenditure is not only for a separate marketable asset but also is apt to be very substantial in relation to the total value of the property. If so, you would treat the expenditure as capital in nature.

Use your social or athletic club for business purposes such as meetings, entertaining, and finding new customers.
TAXTIP

Management & Administration Fees

Management and administration fees you pay to others are deductible business expenses. However, if you are self-employed and pay wages to yourself, this is not considered a deductible expense for tax purposes. For tax purposes, you and the business are all considered to be one individual.

NOTE A payment made by a corporation to a shareholder, is deductible by the corporation. However, it must be recorded as income by the shareholder.

Meals & Entertainment

Generally, you may deduct the costs for business meals and for entertaining clients or customers if you incur these expenses in the ordinary course of business. However, there are restrictions on the deductibility of these expenses.

In the U.S., the amount you can deduct for meals and entertainment are subject to a 50% deduction limit (including reimbursements you make to your employees for expenses they incur while traveling away from home on business and for entertaining business customers at your place of business or a restaurant). For most areas, the standard meal allowance in the U.S. is $26 a day.

If you need some help filing a Schedule C check out Intuit's TurboTax. Although this program won't take the place of an accountant or a tax adviser, using it can leave you with a satisfied feeling that you've done the best you can for yourself without cheating the IRS. This program retails for about $80. ***TAXTIP***

In Canada, the deduction is restricted to 80% of the lesser of the actual expense incurred, and an amount that is reasonable in the circumstances for those expenses.

NOTE The above restrictions don't apply if you are a restaurant, airline or hotel providing meals to customers in the ordinary course of business or to events which primarily benefit a registered charity.

Membership Dues

Annual dues or fees paid to maintain memberships in trade or commercial associations, business leagues, civic or public service organizations, chambers of commerce, or other business-related and professional organizations and societies, are deductible as business expenses. However, membership dues (including initiation fees) paid to any club where the main purpose is to engage in dining, recreational, pleasure, social or sporting activities are not deductible.

Office Expenses

Normal office expenses, such as postage, stationary, printing, photocopying, and general office supplies are deductible as business expenses.

NOTE If however, the office is located in your home, there are restrictions on the deductibility for expenses like gas, electricity, cleaning and repairs based on a percentage of work space divided by total area of home.

Taxes, after all, are the dues that we pay for the privileges of membership in an organized society.
FRANKLIN ROOSEVELT

Rent, Leases & Property Taxes

Depending on whether you own, rent or lease your business premises, property taxes and rental/lease payments are deductible as business expenses.

NOTE If you own a sole proprietorship, you can pay yourself an amount for rent. However, for tax purposes this amount will *not* be a deductible expense.

Research & Experimental Costs

The costs of research and experimentation are generally capital expenses. However, you can choose to deduct these costs as current business expenses. Whichever method you choose, you must apply it to all your research and experimental costs. You can't simply choose to deduct some expenses and capitalize others.

R&D costs include such expenses as those incurred during the process of product development and improvement and the process of obtaining a patent (including lawyer fees). They do not include expenses for quality control testing, efficiency & consumer surveys, advertising promotions or management studies.

NOTE If you do not choose to deduct your research and experimental costs currently, you can choose to treat them as deferred expenses and amortize them over a period of at least 60 months, beginning with the month you first receive an economic benefit from the research.

Start-up costs are classified as “capital expenses” which means they may not be deducted as ordinary business expenses. Rather they must be "capitalized through either a mehtod of depreciaiton or amortization.

Retirement Plans

Retirement plans offer small business owners and individuals, some of the best tax saving opportunities possible. In general, contributions as an employer to an employer-sponsored retirement plan is generally deductible within certain limits (refer to Guidebook #83 for specific details on both U.S. and Canadian retirement plan options). Contributions are not taxed to your employees until plan benefits are distributed to them.

Start-up Costs

Start-up costs are the expenses you incur before you actually begin business. These costs are classified as “capital expenses” which means they may *not* be deducted as ordinary business expenses. Rather they must be "capitalized" through either a method of depreciation or amortization (i.e., you deduct part of your total start-up costs each year over a number of years). These costs include:

- *Going into Business Costs* – These costs include advertising, conducting market surveys, travel to line up customers and suppliers, utilities, repairs, employee wages, fees for professional services, employee training, analysis of facilities, and other costs that are normally deducted when you have them after you open for business.
- *Business Asset Costs* – Such as land, buildings, machinery, furniture, trucks, patents, and franchise rights.

Improvements to a business asset are a capital expense and include anything that adds to the value of the asset, appreciably lengthens the time you can use it, or adapts it to a different use.

- *Improvement Costs* – Improvements to a business asset are a capital expense and include anything that adds to the value of the asset, appreciably lengthens the time you can use it, or adapts it to a different use. Improvements include such items as new electric wiring, a new roof, a new floor, new plumbing, bricking up windows to strengthen a wall, and lighting improvements.

Asset costs are usually recovered through depreciation. Other start-up costs – such as market survey costs, advertising costs, salaries, travel costs, and organizational costs for a partnership or corporation, as well as other expenses normally deductible if paid or incurred to operate an existing trade or business – can be recovered through amortization. This means you deduct them in equal amounts over a period of 60 months or more. If you don't choose to amortize these start-up costs, you generally cannot recover them until you sell or otherwise go out of business.

Asset costs are usually recovered through depreciation.

NOTE For start-up costs to be deductible, on the grounds that it was an expense incurred for the purpose of gaining or producing income from a business, the taxpayer must have been carrying on business in the fiscal period in which the expense was incurred.

Therefore, where a taxpayer proposes to undertake a business and makes some initial expenditures with that purpose in mind, it is necessary to establish whether they preceded the commencement of the business or whether the business had in fact commenced and they were expenses incurred during preliminary steps leading to the start of normal operations. Consequently, the date when the business can said to have commenced must be known.

Generally speaking, a business commences whenever some significant activity is undertaken that is a regular part of the income-earning process in that type of business or in an essential preliminary way to normal operation.

Subcontracting Costs

Fees paid to subcontractors & temporary employees are deductible as expenses.

Subscriptions

Subscriptions to business magazines, trade periodicals, newsletters, or any other form of publication purchased to enhance your business education, or update or upgrade your business skills are tax deductible. Examples of worthwhile business-related publications that you may be able to deduct include: *Venture*, *Money*, *Entrepreneur*, *Maclean's*, *Nation's Business*, *Newsweek*, *Fortune* and trade magazines targeted towards your business.

Subscriptions to business magazines, trade periodicals, newsletters, or any other form of publication purchased to enhance your business education, or update or upgrade your business skills are tax deductible.

Taxes, Fees & Licenses

Special business taxes and the cost of any annual licenses paid each year to state/province or local governments and required by your business, are tax deductible.

Telephone

Telephone equipment, monthly service charges, long distance calls, and telephone answering services and machines are deductible as expenses.

Travel

Expenses that you incur while traveling for business are generally deductible within limitations. Travel deductions include expenses for hotel accommodations, meals, entertainment, rental cars, tips, airline fares, bus fares, train fares, taxi fares, ferry and boat fares, subway fares, baggage and shipping, cleaning, telephone calls and any other business-related expenditures (auto expenses incurred are also deductible).

The main categories or purposes of potentially deductible business travel include:

- attending a business-related education program
- attending a convention or conference
- attending a trade show or association meeting
- buying trips for products to resell
- meetings with current or potential business investors
- setting up distributors for you product or services
- shareholders or partners meeting even in a small, closely held business
- visits or discussions with owners of similar business to keep your business skills sharp

Expenses that you incur while traveling for business are generally deductible within limitations.

NOTE In Canada, the cost of your meals while traveling is generally subject to an 80% limitation discussed under Meals & Entertainment (unless if you are traveling on a plane, train or bus and the cost of meals is included in the ticket price). In the U.S., the deduction is limited to 50% of its cost.

TAX TIP *Plan your trips or vacations around a legitimate business purpose such as those discussed above.* This could make at least part of your travel expenses tax deductible. Keep in mind though, that although you may have lots of fun and enjoyment on your trips, the primary purpose of the deductible trips must be business related.

TAX TIP *A great way to make your international travel deductible is by starting a small importing company.* Your total investment? Two empty suitcases. Take them with you. While you are at your destination, your tax strategy is to go shopping for items you can take back to your country and sell for a profit. It is important though to keep in mind that this strategy only works if the items you sell indeed have a reasonable expectation of profit.

A great way to make your international travel deductible is by starting a small importing company. ***TAXTIP***

Often Missed Deductions

The following deductions are often missed, forgotten about, or not adequately recorded in the first place in order to meet the documentation requirements of tax agencies.

- Auto Rentals
- Bank Service Charges (including safety deposit box rental if it holds documents related to business)
- Briefcases or Samples Case
- Brokerage Fees (deducted when you sell your investments)
- Business Development Costs
- Business Gifts (including donations to charitable or business-related

organizations)

- Business Portion of Trips Incurred to Look After Investments
- Christmas Cards for Business Associates
- Cleaning Services
- Computer Software
- Consulting Fees
- Cost of Collecting Interest and Dividends and Other Investment Income
- Fees Paid to a Bookkeeper Who Keeps Your Investment Records
- Investment Counsel Fees
- Legal Costs to Collect Investment Income
- Mailing List Development & Maintenance
- Mutual Fund Management Fees
- Parking Fees and Tolls
- Penalties and fine paid for late performance or nonperformance of a contract
- Postage Costs
- Professional Services (including designers, artists & copywriters)
- Research & Development
- Retirement Plan Administration Costs (if billed separately)

A few words of caution: Revenue Canada requires residents of Canada to report their world income. If you hide money, tell no one and then die, the bank you selected will be richer and your heirs will be poorer.
TAXTIP

- Tax Preparation Fees
- Tools
- Work Clothes (including uniforms or other modes of dress that contribute to increasing business income)

NOTE Information bulletins and circulars which explain in more detail many of the deductions outlined in this guidebook are available free to the public and can be obtained at your local tax office. These information sources are invaluable since, they set out, in layman's terms, the IRS's and Revenue Canada's interpretation of certain provisions in each respective country's income tax acts (see **page 87** for "Useful IRS Tax Publications).

Perfectly legal and systematic analyses of different tax options can often minimize the amount of taxes a business will pay to the taxman. However, be aware that tax strategies change with every new government and every new budget. Be sure to verify your deductions with a professionally qualified accountant or other tax authority.

TAXTIP

KEEPING YOUR TAX LIABILITY PREDICTABLE

ONE OF the primary tasks of tax planning is to project expenditures, profitability and tax liability over the next 10 to 20 years, and then find ways to keep those factors relatively constant. Although, in a real sense, total tax dollars paid over a long-term period will be about the same, this type of planning helps limit sudden upswings or downswings.

Amortize expansion or startup costs that are unrelated to capital improvements. ***TAXTIP***

For example, if projections show profits will be low in the first years and higher thereafter, you should consider ways of reducing your first years tax liability as well as transferring profits to the first years. The idea being to reduce taxes now, then investing the money so that as taxes become due more money is available. If however, the projections indicate higher taxes or profits in your first years, arrange to pay taxes now or transfer profits to later years.

TAX TIP *Amortize expansion or startup costs that are unrelated to capital improvements.* According to IRS guidelines, costs which are not capital related, but will have a positive effect on sales volume in the future, can be amortized or rather split-up. An example is any expenditure used for research or development that will lead to future increased sales. This cost can be calculated and amortized over a minimum of five years, thus reducing expenses in the current year. A reduction in expenses means more profit in the current year (which also means paying more tax). However, when higher profits occur, amortization will transfer more expenses to that time period, resulting in lower taxes.

The following areas should be considered to be amortized:

- Advertisement related to the expansion
- Agreements not to compete
- Cost of acquiring leases
- Cost of commissions or finder fees
- Organization costs for the form of ownership
- Research, experimental and development costs
- Salaries of those involved in the expansion
- Surveys and market research
- Training for employees
- Travel and related expenses

Consider a fiscal tax year that matches the season and avoids splitting the season into two tax years.

TAX TIP *Change your fiscal year to match the season.* When your begin a business, you choose the operating fiscal year, whether it is a calendar year or some other 12 month period convenient for you. When the business begins to grow, reconsider your fiscal year. If your business becomes highly seasonal, you should consider requesting a change of tax year to avoid splitting the season into two tax years.

SEEKING SANCTUARY IN A TAX HAVEN

TAX HAVENS as a rule don't receive a lot of press. However, despite their secretive reputation, many can be used for legitimate business purposes.

Astute tax planners seek tax havens to pay less or no taxes on their income and to protect their assets. For example, a taxpayer resident in British Columbia in 1996 faces top marginal rates of 54.2 percent, on salary or interest income over $79,446. However, were he or she a resident in the Turks & Caicos Island, an hours flight south east of Miami, income tax liability would be zero.

Citizenship is an asset, which allows you to be protected by the government.

Understanding Residency & Citizenship – Citizenship is an asset, which allows you to be protected by the government. Therefore, citizenship is difficult to obtain. Residency is a liability which allows the government to exploit you and therefore, bestowed on the unwary, and difficult to dispose of.

NOTE In Canada, most provinces don't want you to claim residency, while at the same time the federal government desperately wants you as a resident.

TAX TIP *Obtain citizenship in a different country preferably one belonging to the European Union.* With citizenship in the *European Economic Community* it is possible for you to obtain residency in other countries and thus take advantage of tax situations. This is more true for Canadians. In America, the government restricts you from taking out large capital resources from the country.

Choosing a Tax Haven

Tax havens are no more than jurisdictions with varied laws and tax rates. Canada itself is a tax haven for U.S. taxpayers, who look enviously at our way of taxing inheritances. Canadian rates can be a small fraction of what one pays in the U.S.

Most havens provide few jobs accept for tax lawyers and accountants helping others to squirrel away their assets. ***POWERPOINT***

Shrewd tax planners, shop sites for the advantages they offer. Perhaps they choose Ireland for Personal residency; the Turks & Caicos for a family or personal trust; or Switzerland or Liechestein for professional financial management.

NOTE For more information on this subject, consult *Tax Havens and Their Uses* available from The Economist Bookstore, 10 Rockerfeller Plaza, New York, N.Y. 10020. (212) 541-0500.

Austria – In Austria, you have a choice of no taxation of remittances received by non-residents or low tax rates that allow other jurisdictions to give credit for taxes paid. Extensive bank secrecy, but inheritance taxes can be stiff.

NOTE Any large Austrian bank can provide an account for a non-resident that is exempt from Austrian income taxation. The official will ask the name in which you want your account kept and if you want to receive account statements. However, secrecy has a downside, if people use a pseudonym with an Austrian bank and then forget it, the account is lost. There is no backup.

Senior havens, like Switzerland, are definitely not for people who have dirty money. Arrive with a suitcase full of cash, a lame story, a request for a numbered account that only two officers will be able to associate with your name, and the bank will throw you out. Another bank, perhaps one is Austria might do business. ***SUPERTIP***

Bahamas – The Bahamas populus is composed of about 250,000 people scattered among an idyllic group of islands. This tax haven offers no income, corporate nor capital gains taxes and not estate duties on death. It has a good banking infrastructure, and residence permits relatively easy to get.

NOTE There is no tax treaty or information sharing with Canada.

Bermuda – Bermuda is the oldest self-governing colony in the Commonwealth. It offers no income, corporation, capital gains or withholding taxes. The financial system is modern, but the island stills has signs of a strong colonial spirit.

Cayman Islands – The Cayman Islands tax system was designed by Canadian lawyer Jim MacDonald. There is no income, corporation or capital gains taxes, no withholding tax, and no estate duties. The Cayman Islands has excellent links with the rest of the world, a vast choice of banks, and more lawyers per capita than any other country. However, authorities are picky about residence permits.

Ireland – For Canadians, Ireland has a low tax rate for expatriates remittances sent from abroad. This means that come retirement, you can withdraw all your RRSP funds and save a bundle in taxes.

Lichestenstien – Lichestensien is a tiny country sandwiched between Switzerland and Austria. It has moderate income taxes, but more importantly offers special foundation and trust laws that can achieve rare levels of discretion. It follows Swiss banking practices, meaning that money without a checkable lineage is not accepted. Permanent residency is almost impossible to get.

Contrary to popular belief, income taxes in Switzerland are substantial, as well, living costs are high.

Switzerland – Contrary to popular belief, income taxes in Switzerland are substantial, as well, living costs are high. However, foreigners flock to Zurich for the professional management and integrity of the banks. Expect stiff bank charges and disrespectful treatment for small fry accounts. However, if you have, let's say $10 million, banking personnel will be more than happy to assist you.

Turks & Caicos Islands – Situated in an island cluster southeast of the Bahamas, Turks & Caicos is a British colony with a governor, squeaky clean banking, no taxes on personal or corporate income, not much infrastructure, and lots of tax lawyers and accountants.

TAX TIP *Set up an offshore trust to protect* *your assets.* Although a trust does not eliminate the need to report income from it to Revenue Canada or the IRS, the offshore sites of the assets make it immensely more difficult for creditors to collect. Imagine if you were being sued by an unscrupulous opportunist who happened to slip on a banana peel in front of your store. Being that a lot of these cases have a short statute of limitations, time is on the side of the trust.

Corporate Income Tax Rate & Capital Gains Tax rate is 0% on the Cayman Islands and in the Bahamas. ***FUNFACT***

WHERE TO GET PROFESSIONAL TAX ADVICE

THE CHART on **page 87** lists forms and publications offered by the IRS to help you complete your tax forms correctly.

To get these forms and publications call 1-800-TAX-FORM (1-800-829-3676) between 8 a.m. and 5 p.m. weekdays, 9 a.m. to 3 p.m. Saturdays. You should receive your order or notification of its status within 15 workdays of your call. You can also visit your local IRS office or a participating post office or library. The IRS also offers a CD-ROM which contains over 600 current year IRS tax forms, instruction, and TIPs. To order this CD-ROM contact the Government Printing Office's Superintendent of Documents. The cost of the CD is $46.

The IRS also offers a CD-ROM which contains over 600 current year IRS tax forms, instruction, and TIPs.

To order free publications & forms call:

1-800-TAX-FORM
(1-800-829-3676)

Small Business Tax Education Program – Small business owners and other self-employed individuals can learn about business taxes through a unique partnership between the IRS and local organizations. Through workshops and in-depth tax courses, instructors provide training on starting a business, recordkeeping, preparing business tax returns, self-employment tax issues, and employment taxes. Some courses are offered free, others may have a nominal fee to offset administrative costs of the sponsoring organizations. For more information on these programs contact the IRS office closest to you or call 1-800-829-1040.

Small Business Tax Kit – The IRS also offers a Business Tax Kit which contains an assortment of IRS forms and publications to help taxpayers who operate their own businesses. To order the kit, call 1-800-TAX-FORM.

Telephone Help – You can call the IRS with your tax questions Monday through Friday during regular business hours. Check your telephone book for the local number or you can call:

IRS Hotline (Monday to Friday)

1-800-829-1040

There is just one thing I can promise you about the outer-space program – your tax dollar will go farther.
WERNHER VON BRAUN

Computer Help – If you have access to a personal computer, a modem, and subscribe to an on-line service, you can also get many forms and publications electronically. IRIS (Internal Revenue Information Services) is housed within FedWorld, known as the electronic market place of U.S. Government information. FedWorld offers direct dial-up access by modem at (703) 321-8020; by File Transfer Protocol (FTP) at ftp.fedworld.gov; or by World Wide Web at:

http://www.ustreas.gov

Ernst & Young's International Business Series

ERNST & YOUNG IS A LEADING international professional services firm with almost 10,000 tax professionals located in the principal cities of the world. It provides public accounting, tax and management consulting services. It also publishes an International Business Series prepared for use by clients and staff.

The purpose of this series is to give the busy executive a quick overview of the investment climate, tax system, forms of business organization, and accounting practices in the country being profiled.

Over 130 countries are profiled (e.g., "Doing Business in Germany," "Doing Business in Italy." U.S. edition is 130 pages).

Included in this series is a "Worldwide Corporate Tax Guide and Directory" which summarizes briefly the corporate tax systems of over 130 countries.

Updates for the "Worldwide Corporate Tax Guide and Directory" are available on the Internet Worldwide Web at the following address: http://www.ey.com. Copies may be obtained at:

Ernst & Young LLP
787 Seventh Avenue
New York, NY 10019
United States
Phone: 1/212/773-3000
Fax 1/212/773-1996

NOTE Price Waterhouse, another leading professional services firms, also publishes an International Business Series virtually identical to Ernst & Young's. Either or both of these series should be available at your public library.

PROS & CONS of Owning a Business in the U.S.

Tax Liability in the U.S.

For corporations, tax rates range from 15% for taxable income under $50,000 to 38% for taxable income over $15,000,000. U.S. Personal service corporations are subject to a flat income tax rate of 35%.

Tax Advantages In the U.S.

- Mortgages can be written off in the U.S., as well as boats for entertainment.
- Section 179 (also known as investment credit) allows immediate 100% write-offs of office furniture, equipment and other qualified fixed assets that would otherwise be depreciable over a longer period of time (between three to five years). In 1992, the ceiling on this deduction was $10,000; new tax legislation has bumped up the deduction to $17,500.
- Meals and entertainment deductions are generally limited to 50% of the costs incurred.
- Corporations can receive a *dividends-received deduction* to help avoid double taxation.

PROS & CONS of Owning a Business in Canada

Tax Liability in Canada

For corporations, the combined federal provincial income tax (in Alberta) on net profits is 47% and if the income is from manufacturing or processing the rate is 41%.

Tax Advantages In Canada

- The small business $500,000 capital gains exemption.
- Small Business Deductions are available to Alberta Resident Canadian Controlled Private Corporations, which have a net active business income of $200,000 or less per year. The small business deductions reduce the combined federal and provincial tax rate for manufacturers and processors to 10%.
- *Federal Dividend Tax Credit* – In Canada, dividend income receives favorable treatment over interest income and capital gains under the Income Tax Act, via the Federal dividend tax credit. Under the dividend tax credit you can receive a tax credit on dividends earned. Because dividends are paid out of a company's after-tax income, to avoid double taxation, Revenue Canada gives you a credit, which reduces the total tax you pay (this means that your after-tax income from dividend income can be higher than from traditional fixed income investments such as GICs).
- Meals and entertainment deductions are generally limited to 80% of the costs incurred.

Which Form Must I File in the U.S.		
Sole Proprietor	Income tax	1040 and Schedule C or C–EZ[1] (Schedule F for farm business)
	Self-employment tax	1040 and Schedule SE
	Estimated tax	1040-ES
	Employment taxes: – Social security and Medicare taxes and income tax withholding – Federal unemployment (FUTA) tax – Depositing employment taxes	943 for farm employees 941 for all others 940 or 940-EZ 8109
	Excise taxes	*See Excise Taxes*
Partnership	Annual return of income	1065
	Employment taxes	Same as sole proprietor
	Excise taxes	*See Excise Taxes*
Partner in a Partnership **(individual)**	Income tax	1040 and schedule E [2]
	Self-employment tax	1040 and Schedule SE
	Estimated tax	1040–ES
Corporation or S Corporation	Income tax	1120 or 1120–A (corporation) 1120S (S corporation)
	Estimated tax	1120–W (corporation only) and 8109
	Employment taxes	Same as sole proprietor
	Excise taxes	*See Excise Taxes*
S Corporation Shareholder	Income tax	1040 and Schedule E[2]
	Estimated tax	1040–ES

[1] File a separate schedule for each business.

[2] Various other schedules may be needed.

“Personal” Tax at a Glance for the U.S. and Canada.

U.S.	
Income Tax Rate	39.6%
Capital Gains Tax Rate	28% [a]
Net Worth Tax Rate	0
Estate and Gift Tax Rate	55%

a) Tax rate on long-term gains. The maximum rate of tax on short-term gains is 39.6%.

CANADA	
Income Tax Rate	52.92% [a]
Capital Gains Tax Rate	36.69% [b]
Net Worth Tax Rate	0
Estate and Gift Tax Rate	0

a) This is a combined rate for 1996 in Ontario, which consists of a federal component of 31.32% and a provincial component of 21.60%.

b) 75% is included in income as taxable capital gains.

“Corporate” Tax at a Glance for the U.S. and Canada

U.S.	
Corporate Income Tax Rate	35% [a]
Capital Gains Tax Rate	35%
Branch Tax Rate	35 % [a]
Withholding Tax	
Dividends	30% [c]
Interest	30% [c] [d]
Royalties from Patents, Know-how, etc.	30% [c]
Branch Remittance Tax	30%[e]
Net Operating Losses (Years)	
Carryback	3
Carryforward	15

a) In addition, many states levy income or capital-based taxes. An alternative minimum tax is imposed.

b) Rates may be reduced by treaty.

c) Applicable to payments to nonresidents.

d) Interest on certain “portfolio debt” obligations issued after July 18, 1984, and noneffectively connected bank deposit interest are exempt from withholding.

e) This is the branch profits tax (see Section D).

CANADA	
Corporate Income Tax Rate	29.12% [a]
Capital Gains Tax Rate	21.84% [a] [b]
Branch Tax Rate	25% [c]
Withholding Tax	
Dividends	25% [d]
Interest	25% [d]
Royalties from Patents, Know-how, etc.	25% [d]
Branch Remittance Tax	25% [d]
Net Operating Losses (Years)	
Carryback	3
Carryforward	7

a) The rate is applied to income that is not eligible for the manufacturing and processing deduction or the small business deduction. It comprises a basic rate of 28% plus a 4% surtax. Additional tax is levied by the provinces and territories of Canada, and the combined federal and provincial or territorial rates vary from 38.02% to 46.12. The basic rate on Canadian manufacturing and Processing income (excluding surtax) is 21%.

b) 75% of capital gains is subject to tax.

c) This tax is imposed in addition to the regular corporate income tax.

d) Final tax applicable only to nonresidents. The rate may be reduced by a tax treaty.

How Long Should You Keep Your Records?

RETAIN INDEFINITELY:

- ☐ Audit reports & financial statements
- ☐ Canceled checks for taxes, capital purchases, & important contracts
- ☐ Capital stock & bond records
- ☐ Income & Sales Journals
- ☐ Contracts & leases that are current
- ☐ Copyright, patents & trademark registrations
- ☐ Corporation charters, minute books of meetings (if incorporated) & by-laws
- ☐ Correspondence on legal & tax matters
- ☐ Deed, mortgages, easements & other property records
- ☐ General and private ledger sheets
- ☐ General journals if they are essential to the understanding of the general ledger entries
- ☐ Insurance records
- ☐ Property appraisals
- ☐ Share records
- ☐ Special contracts and agreements
- ☐ Tax returns, including supporting records & work papers

RETAIN 7 YEARS:

- ☐ Accounts Payables & Receivables Ledgers
- ☐ All canceled cheques indicating outlays of money
- ☐ All operating expenses, such as rent & advertising
- ☐ Asset records
- ☐ Bad debt deduction
- ☐ Capital expenditures
- ☐ Charitable donations
- ☐ Employee disability benefits records
- ☐ Employee taxes a & withholding statements
- ☐ Inventory records
- ☐ Invoices & sales records
- ☐ Monthly trail balances
- ☐ Old contracts & leases
- ☐ Payroll records & time sheets
- ☐ Plan cost ledgers
- ☐ Purchase orders
- ☐ Remittances of Unemployment Insurance premiums & Canada Pension Plan contributions where applicable
- ☐ Vouchers for payments to vendors, employees, & so on

RETAIN 3 YEARS

- ☐ Bank reconciliations
- ☐ Expired insurance policies (no cash value)
- ☐ Personnel files on departed employees
- ☐ Petty cash vouchers

RETAIN 2 YEARS

- ☐ General correspondence
- ☐ Requisitions

Useful IRS Tax Publications	
Number	*Subject*
1040	U.S. Individual Income Tax Return
Sch C	Profit or Loss from Business (Sole Proprietorship)
Sch D	Capital Gains & Losses
Sch SE	Self-Employment Tax
1040ES	Estimated Tax for Individuals
SS-4	Application for Employer Identification Number
SS-5	Application for Social Security Card
1065	U.S. Partnership Return of Income
1120	U.S. Corporation Income Tax Return
1120S	U.S. Income Tax Return for an S Corporation
W-2	Wage and Tax Statement
W-4	Employee's Withholding Allowance Certificate
940	Employer's Annual Federal Unemployment (FUTA) Return
15	Employer's Tax Guide (Circular E)
334	Tax Guide for Small Business
463	Travel, Entertainment & Gift Expenses
505	Tax Withholding and Estimated Tax
510	Excise Taxes for 1996
529	Miscellaneous Deductions
533	Self-Employment Tax
535	Business Expense
538	Accounting Periods and Methods
541	Tax Information on Partnerships
542	Tax Information on Corporations
552	Recordkeeping for Individuals
560	Retirement Plans for the Self-Employed
583	Starting a Business and Keeping Records
587	Business Use of Your Home
589	Tax Information on S-Corporations
590	Individual Retirement Arrangements (IRAs)
910	Guide to Free tax Services
917	Business Use of a Car
946	How to Depreciate Property