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Chapter 1

Your Legal Entity

CHAPTER 1

SELECTING A LEGAL ENTITY

One of the first major decisions you will have to make as you start your new business is the form of legal entity it will take. To a large degree this decision may be dictated by the way you have organized your operations and whether you intend to work on your own or in conjunction with others.

The form of entity you choose can have a significant impact on the way you are protected under the law and the way you are affected by income tax rules and regulations. There are five basic forms of business organizations. Each has its own benefits and drawbacks and is treated differently for legal and tax purposes.

Sole Proprietorship

A sole proprietorship is typically a business owned and operated by one individual, or very often by a husband and wife. A sole proprietorship is not considered to be a legal entity under the law, but rather is an extension of the individual who owns it. The owner has possession of the business assets and is directly responsible for the debts and other liabilities incurred by the business. The income or loss of a sole proprietorship is combined with the other earnings of an individual for income tax purposes.

A sole proprietorship is perhaps the easiest form of business to own and operate because it does not require any specific legal organization, except of course, the normal requirements such as licenses or permits. A sole proprietorship typically does not have any rules or operating regulations under which it must function. The business decisions are solely the result of the owner's ability

Points to Consider

1. You must apply for a GST/HST number if the business has annual sales of $30,00.00 or more worldwide
2. You may operate the business under your legal name but that name must appear on all invoices. Cheques will be made out to the name of the sole proprietor.
3. You may choose to register a commercial business name. In which case all invoices must bear the business name and cheques must be made out to the business name.
4. It is recommended you open a bank account in the business name.
5. Year-end should be December 31st. If you choose an alternate date you should refer to Chapter 5 or your Professional Accountant.

Partnerships

Partnerships can take two legal forms, general or limited liability.

General Partnership is comprised of two or more individuals, corporations, partnerships or trusts who join together to run the business enterprise for a profit. Each of the individual partners has ownership of company assets and responsibility for liabilities, as well as authority in running the business. The authority of the partners, and the way in which profits or losses are to be shared, can be modified by the partnership agreement. The responsibility for liabilities can also be modified by agreement among the partners, but partnership creditors typically have recourse to the personal assets of each of the partners for settlement of partnership debts.

Limited Liability Partnership is comprised of one or more general partners who are personally liable for partnership debts and one or more limited partners who contribute capital and share in the profits or losses of the business. The limited
Partners do not take a part in running the business and are not liable for the debts of the partnership.

The rights, responsibilities, and obligations of both the limited and general partners are typically detailed in a partnership agreement. It is a good idea to have such an agreement for any partnership, whether limited or general.

A partnership is a legal entity recognized under the law and as such it has rights and responsibilities in and of itself. A partnership can sign contracts, obtain trade credit, and borrow money. When a partnership is small most creditors require a personal guarantee of the general partners for credit.

A partnership is reported for income tax purposes as part of each individual partner T1 return identifying all partners, their social insurance numbers and the allocation of net income or loss for the year.

Corporation

A corporation is a separate legal entity, which exists under the authority granted by provincial or federal law. A corporation has substantially all of the legal rights of an individual and is responsible for its' own debts. It must also file income tax returns and pay taxes on income it derives from its operations. Typically, the owners or shareholders of a corporation are protected from the liabilities of the business. However, when a corporation is small, creditors often require personal guarantees of the principal owners before extending credit. The legal protection afforded the owners of a corporation can far outweigh the additional expense of starting and administering a corporation.

A corporation must also adopt and file articles of incorporation and by-laws, which govern its rights and obligations to its shareholders, directors, and officers.

Corporations must file annual income tax returns with the both the CCRA and the provinces in which it does business. In the province of Ontario the Ontario income tax is administered by CRA and hence there is only one tax return to be filed. The elections made in a corporation's initial tax returns can have a significant impact on how the business is taxed in the future.

Incorporating a business allows a number of other advantages such as the ease of bringing in additional capital through the sale of equity, or allowing an individual to sell or transfer their interest in the business. It also provides for business continuity when the original owners choose to retire or sell their interest.

Should you decide to incorporate your business venture, you should seek the advice of competent legal counsel and business-oriented accountants.

Chapter 2

Registering
With
The Tax Department

CHAPTER 2

REGISTERING WITH THE TAX DEPARTMENTS

A significant task for the new business owner is assuring that the business is properly complying with the extensive tax and information filing requirements imposed by various governmental agencies. Stiff penalties are commonly assessed if the required forms and returns are not properly prepared and timely filed. There are several forms required to be filed when the business is started. While this chapter is not intended to be an all-inclusive list of the filing requirements, it summarizes some of the more prominent requirements common to most businesses. Many industries have specific filing requirements, which are not part of this text, but which nevertheless, must not be overlooked. Professionals with experience in your industry should be consulted to assure that any such filings are properly handled.

Canada Customs and Revenue Agency

All tax forms filed with the Canada Customs and Revenue Agency (CCRA) require the use of a Business Number. This number is obtained by filing a Form RC1 with the Canada Customs and Revenue Agency. An example of Form RC1 is in the Exhibit Section.

Most filings with the Canada Customs and Revenue Agency come under the headings of income and payroll taxes. Payroll tax requirements are detailed in Chapter Four. Income tax filing requirements and tax planning are discussed in Chapter Six.

Tax Calendar

The following summarizes some of the more significant filing dates for a corporation using a calendar year-end. Many of these requirements also apply to partnerships and sole proprietorships. Naturally, if a year-end other than December 31st is used (see Chapter Five) some of these dates will vary.

DATE	***RETURNS***
January 31st	Quarterly GST returns due
February 28th	Form T4 filed with CCRA
March 31st	Estimated corporate income tax returns liabilities due
April 30th	Individual income tax returns Quarterly GST returns due
June 30th	Corporate tax returns due
July 31st	Quarterly GST returns due
October 31st	Quarterly GST returns due
November – December	Year-end tax planning

There are also various deadlines for payroll deductions and GST returns depending on the size of the corporation.

- Larger companies may have to file sales tax returns on a monthly, quarterly or semi-annual basis.

Ontario Retail Sales Tax

You should register for a retail sales tax (RST) Vendor Permit if you charge, collect and remit RST on your taxable sales.
You must obtain an RST Vendor Permit if:

- you regularly sell taxable goods
- you regularly provide taxable services
- you regularly sell insurance
- you charge more than $4 admission to a place of amusement
- you are a manufacturing contractor, that is, the manufactured cost of goods you use in real property contracts is more than $50,000 in any fiscal year
- you are a non-resident contractor doing business in Ontario
- you sell taxable goods or services at flea markets, fairs or exhibitions
- you regularly import taxable goods or taxable services into Ontario for your own use (courtesy www.rev.gov.on.ca)

How do you apply?
Pease visit www.rev.gov.on.ca and click on “Who Should Be Registered)

CHAPTER 3

ACCOUNTING AND BOOKKEEPING

CHAPTER 3

ACCOUNTING AND BOOKKEEPING

Most operators of a new and growing business have a flair for the environment in which the business operates. They may be a great salesperson, an outstanding mechanic, carpenter, lawyer, or inventor. Unfortunately most people do not like to keep the books. As an owner of a business you must remember that your company's books and financial statements represent a score sheet which tells how you are progressing, as well as an early warning system which lets you know when and why the business may be going amiss. Financial statements and the underlying records will provide the basis for many decisions made by outsiders such as banks, landlords, potential investors, and trade creditors as well as taxing authorities and other governing bodies. The necessity for good, well-organized financial records cannot be over-emphasized. One of the greatest mistakes made by owners of small businesses is not keeping good financial records and making improper or poor business decisions based on inadequate information.

Quality financial information does not necessarily translate into complicated bookkeeping or accounting systems. Far too often owners of businesses become overwhelmed by their accounting system to the point where it is of no use to them. An accounting or bookkeeping system is like any tool used in your business; it needs to be sophisticated enough to provide the information you need to run your business and simple enough for you to run it (or supervise the bookkeeper). Questions you should ask in developing an accounting and financial reporting system are:

1. Who will be the users of the financial information?

2. What questions do I need answered to manage the business?

3. What questions should be answered for government or regulatory taxing authorities?

As your business grows, you should work closely with your accountant to ensure that your accounting system is providing you with appropriate information.

Chart of Accounts

The basic road map into any accounting system is the chart of accounts. It is this chart, which helps establish the information, which will be captured by your accounting system, and what information will subsequently be readily retrievable by the system. This tool, like the rest of the accounting systems, needs to be dynamic and should grow as the size and needs of your business changes.

To help establish a good working chart of accounts you need to answer some questions, in conjunction with your accountant, as to how your business will operate, and what is important to you. Some of these considerations might be:

1. Will your business have inventory to account for? If so, will it be purchased in final form or will there be production costs?

2. Are fixed assets a significant portion of your business?

3. Will you sell only one product or service or will there be several types of business?

4. Will you have accounts receivable from customers, which you will need to track?

5. Are you going to sell in only one location or will you do business in several locations?

6. Are the products you sell subject to sales tax?

7. Do you need to track costs by department?

8. What type of government controls or regulatory reporting are you subject to?

Each one of these questions can have several answers and will probably generate more questions. Each answer will have an impact on how the chart of accounts is structured. It may seem that developing a chart of accounts is not particularly high on your list of things to do as you start a new business; however a well thought our organized accounting system will save you significant time and expense and insure valuable information to make strategic decisions. An example of a basic chart of accounts follows this section.

Cash or Accrual Accounting

One of the decisions to be made as you start a business is whether to keep your records on a cash or accrual basis of accounting.

The cash basis of accounting has the advantage of simplicity and almost everyone understands it. Under the cash basis of accounting you record sales when you receive the money and account for expenses when you pay the bills. The increase in the money in "the cigar box" at the end of the month is how much you made.

Unfortunately, as we all know, the business world is not always so easy. Sales are made to customers and you sometimes must extend credit. Your business will incur liabilities which are due even though you may not have received the invoice or have the cash available to pay them.

Most users of financial statements such as bankers and investors are accustomed to **accrual basis** statements and expect to see them. Once you become familiar with them, they provide a much better measuring device for your business operations than cash basis statements.

Whether you use the cash or accrual basis, it is possible to keep books for income tax purposes on a different basis than for financial statements. It may be more advantageous (less tax) for you to do so. Your accountant can advise you on the advantages and feasibility of doing this in your particular circumstances.

Accounting Records and Record-Keeping

Another question, which the owner of a business must answer, is "Who will keep the books of the business?" Will you do it yourself, will the receptionist or a secretary double as a part-time bookkeeper, will you have a bookkeeper that comes in periodically, or will the volume of activity be such that a full-time bookkeeper will be required?

Very often the owners of a business decide to keep the books themselves and underestimate the commitment they have made to other phases of the operation and the time required to maintain a good set of financial records and books of account. As a consequence, the record keeping is often low priority and must be caught up later. This approach, though rarely planned, can require a substantial expenditure of time and money. While it is important for the owners of a business to maintain control and stay involved in the financial operations of the enterprise, maintaining close control over the cheque signing function and scrutinizing certain records can achieve this. Your company's accountant can help develop a good program of record keeping duties for you, your employees and any outside bookkeepers you may engage.

A Word about Computers

The computer is probably the single most valuable invention for bookkeeping and accounting since the advent of double entry bookkeeping. If your business includes any of the following then a computer would be a useful tool in your business.

1. Many repetitious or routine tasks

2. Lots of paperwork; i.e., payroll checks, invoices, purchase orders, mailing labels.

3. Lots of general correspondence

4. Written reports, contracts, newsletters, catalogues or brochures.

Your accountant knows both your business and computers so he or she can take much of the confusion out of the selection process by assisting you in the purchase and installation of your computer and software.

There are a number of very good; easy to use accounting software systems, which are commercially available, but none of them will solve the problems of inaccurate or poor quality financial records. All they will do is generate bad information faster. This is one of the reasons that the computer has also probably caused more headaches for the owners of modern businesses than any other single cause. If you want to use a computer based accounting package, either in your own business, with a service bureau or through your accountant, it is imperative that you generate accurate information to be entered into the system.

The real value of the computer becomes apparent once it is running smoothly in your business. Your accountant can then function in the capacity for which he was trained not as a "number cruncher", but as your business advisor, consultant, and strategist. Both of you can focus not on producing reports for various regulatory agencies but on analyzing your business to make it more profitable.

Internal Control

What is internal control? It is the system of checks and balances within a business enterprise, which helps to ensure that the company's assets are properly safeguarded and that the financial information produced by the company is accurate and reliable. When you're operating as a "one man shop" or at least handling all of the company's financial transactions, maintaining good internal accounting control is relatively straightforward.

However, when your company grows to the size where you must delegate some of the functions it becomes more difficult to ensure that all the transactions are being accounted for properly.

No matter the size of your business, you should always be able to answer "yes" to the following questions:

1. When my company provides goods or services to our customers, am I sure that the sale is recorded and the revenue is recorded in accounts receivable or the cash is collected?

2. When cash is expended by my company, am I sure we received goods or services?

The methods used to ensure that these two questions can be answered affirmatively will vary widely. The solution in your particular instance may be as simple as numbering the sales tickets and being sure **ALL TICKETS ARE ACCOUNTED FOR** or reviewing all invoices and timecards before signing company checks. These are fundamentals in a well-run business. As the company grows you will need to consider concepts such as segregation of authority as well as employee fidelity bonds or controlled access storerooms. These are essential stepping-stones to maintaining good control in your business.

No matter what the size of your enterprise, you should consider controlling your business and safeguarding hard earned assets as a priority from the outset.

Illustrative Chart of Accounts

Current Assets:

1000 Cash
1120 Accounts Receivable
1125 Allowance for Uncollectible
1130 Inventory
1140 Prepaid Rent
1150 Prepaid Expenses

Fixed Assets:

1310 Equipment
1320 Furniture and Fixtures
1330 Automobile
1340 Leasehold Improvements
1350 Accumulated Depreciation

Intangible Assets:

1410 Goodwill
1420 Organizational Costs
1430 Accumulated Amortization
1440 Deposits

Current Liabilities:

2100 Notes Payable
2110 Accounts Payable
2120 Interest Payable
2130 Salaries Payable
2140 Income Tax Payable
2150 Sales Tax Payable
2160 Federal Payroll Withholding Tax Payable
2170 Provincial Payroll Withholding Tax Payable
2180 Unemployment Insurance Premiums Payable
2190 Canada Pension Plan Premiums Payable
2200 Advances from Customers

Long-Term Liabilities:

2410 Mortgage Payable
2420 Credit Line Payable

Stockholder's Equity:

3510 Capital Stock

3650 Retained Earnings

Illustrative Chart of Accounts

Revenue:

4000 Sales
4100 Returns and Allowances

Cost of Goods Sold:

5100 Purchases
5110 Freight
5120 Direct Labor

Expenses:

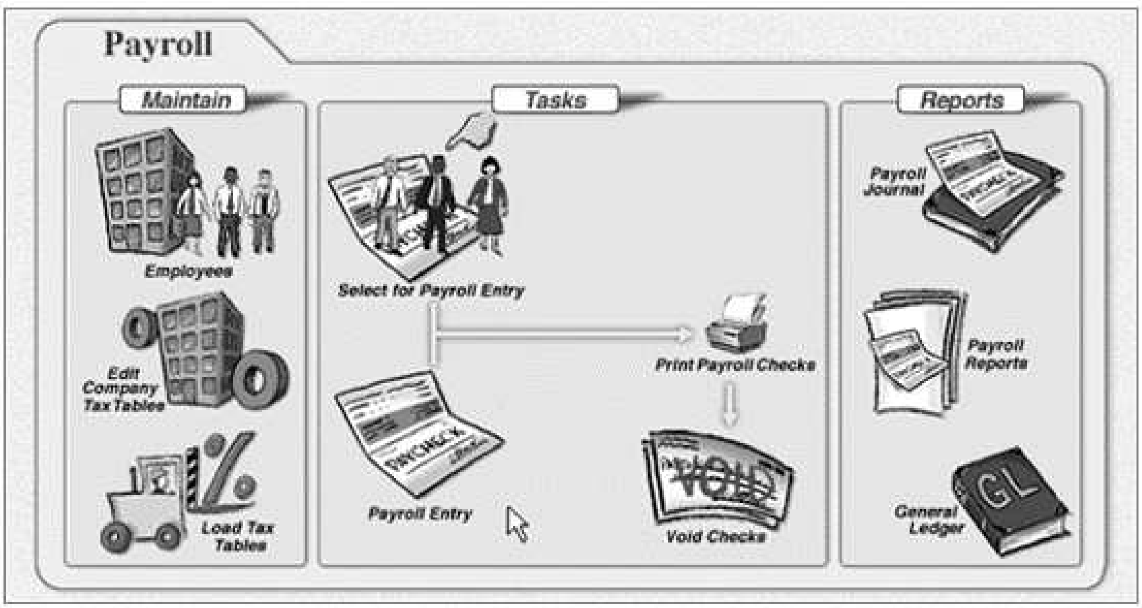
6010 Advertising
6020 Bank Charges
6030 Contract Labor
6040 Depreciation and Amortization
6050 Dues and Subscriptions
6060 Employee Benefits
6070 Insurance
6080 Interest Expense
6090 Janitorial
6100 Legal and Professional Fees
6110 Meals and Entertainment
6120 Office Expense
6130 Payroll
6140 Postage and Shipping
6150 Rent
6160 Repairs and Maintenance
6170 Supplies
6180 Taxes – Income
6190 Taxes – Payroll
6200 Taxes – Other
6210 Telephone
6220 Travel
6230 Utilities

Other Revenue:

7010 Interest Income
7020 Other Income

CHAPTER 4

PAYROLL TAXES



CHAPTER 4

PAYROLL TAXES

Irrespective of the form of business in which you operate, if you are going to have employees then you will have to contend with deductions for Canada Pension Plan (CPP) contributions, Employment Insurance (EI) premiums and income tax from remuneration. You must remit payment to the CRA and report on the applicable slips. The brief summary, which follows, will give you some guidance in the rules and regulations of the various taxing authorities.

If you operate as a proprietorship or partnership your draws are NOT considered salary and deductions for Income Tax, CPP and EI are not required. (However if the proprietorship or partnership employs your spouse and any other family members who are NOT partners, they are considered employees for Payroll Deduction purposes.)

If you operate as an incorporated entity, a Company, and you take a salary you are considered an employee, likewise for your spouse and any other family members helping in the business.

Available Publications

Form T4001, Employer's Guide to Payroll Deductions, covers the payroll tax reporting and deposit requirements and can be obtained through the local office of the Canada Customs and Revenue Agency or on their website at www.cra-arc.gc.ca.

Tax Deposit Requirements

As a new remitter, you are considered a Regular remitter for the first calendar year.
You must remit all employee deductions on or before the 15th day of each month following the month of actual deduction. Your first payment may go to any tax centre (found on the website with a cheque or money order made payable to the Receiver General and include a letter stating:

- that you are a new remitter;
- the period your remittance covers;
- Your complete employer name, address, and business telephone number; and
- Your Business Number, if you have one.

After that first remittance is received CCRA will send you a remittance form in the mail each month recording past deposits and a mailing address for all subsequent remittances.

For complete information on an employers' responsibility for remitting payroll deductions visit the CRA website www.crs-arc.gc.ca and click on form RC4163.

Canada Pension Plan (CPP)

You have to deduct CPP contributions from an employee's remuneration if the employee is 18 or older but younger than 70. The employment must be pensionable during the year, and the employee cannot be receiving a CPP retirement or disability pension.

You have to contribute the same amount of CPP that you deduct from your employee remuneration. For 2010, the maximum you deduct is $2,163.15 and remit $4,326.30 per employee

You stop deducting CPP contributions when you reach the maximum employee contribution for the year.

Employment Insurance (EI)

Once you have employees you must deduct EI premiums from the employee's pay on every dollar of insurable earnings up to the yearly maximum. As an employer, your EI premium is 1.4 times the EI premium withheld for each employee. For 2010 the maximum you deduct is $747.36 and remit $1,793.66 per employee. You stop deducting EI premiums when you reach the yearly maximum employee contribution.

If you own 40% or more of the company you, your spouse and other family members May not be covered under EI and thus no deductions are required.
Note: This is a very complex area and you should seek advice from your professional accountant to determine whether you are exempt from EI.

There is no age limit for deducting EI premiums.

Summary

The payroll tax requirements and the work related to compliance are quite cumbersome and complicated. Once a business employs more than a few people, we recommend using, either a payroll package such as those that integrate with Simply Accounting® and Quickbooks® or use an external payroll service.

Tax Rates

The following charts contain tax rates and the taxable wage basis for employers and employees. The limits and maximum contributions for 2010 given are per employee.

CPP and EI Tax Rates

	CPP	EI	Total
Tax rate for employer	4.95%	2.42%	7.37%
Tax rate for employee	4.95%	1.73%	6.68%
On wages not to exceed	$47,200	$43,200	
Basic Yearly exemption	$3,500	-	
Maximum employer contribution	$2,163.15	$ 1,046.30	
Maximum employee contribution	$2,163.15	$ 747.36	

Workplace Health, Safety and Compensation

Most businesses in Ontario that employ workers (including family members and subcontractors) must register with the Workplace Safety and Insurance Board (WSIB) within 10 days of hiring their first full-or-part-time worker. It is the law!

There are a few industries that **do not** have to register. These include:

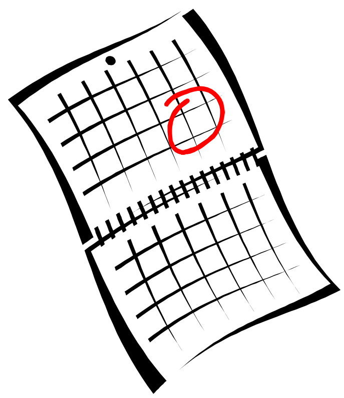
- Banks, trusts and insurance companies
- Private health care practices (such as those of doctors and chiropractors)
- Trade unions
- Private day cares
- Travel agencies
- Clubs (such as health clubs)
- Photographers
- Barbers, hair salons, and shoe-shine stands
- Taxidermists
- Funeral directing and embalming

Courtesy www.wsib.on.ca

Registration is simple please visit www.wsib.on.ca for their 4-Step program.

CHAPTER 5

SELECTING A YEAR-END



CHAPTER 5

SELECTING A YEAR-END

If the new business is a sole proprietorship or a partnership, the company will usually be required to use a calendar year-end. However, if the business is incorporated, the corporation is often allowed to select a fiscal year-end using a month end other than December.

Which Month to Choose

The selection of a year-end involves several considerations. The most important factor is the ease by which data is accumulated. For this purpose, most companies prefer to use a quarter-end as the last day of the fiscal year (e.g. March 31st, June 30th, September 30th, or December 31st). Many companies not using a quarter-end date find that it complicates several government filings and can be confusing to shareholders and others when disclosing quarterly data.

A second consideration involves the nature and seasonal fluctuations of the business. As a general rule, the year-end causes a disruption to the normal course of business, especially if a physical inventory is required. It is usually better to have this disruption occur during the off-season. Also, since the periods just before and just after year-end often involve an additional time commitment by the key officers, a year-end that does not conflict with normal vacation schedules is preferable.

There are also tax reasons to select a year-end other than December 31st. If the company has, for example, a June 30th year-end, it is possible for the corporation to pay bonuses in June and obtain a tax deduction. The employee then has six months to decide whether to pay tax currently on the income or attempt to shelter it.

Proper planning in selecting a year-end can also defer the payment of taxes at the corporate level. Suppose the company incorporated in July and operated at break-even through the next April, but expected May and June to be big income months. By selecting a March or April year-end, the company can delay for ten months the payment of taxes on the May and June income. Since cash is often scarce for a start-up company, this deferral can be of significant benefit.

How to Make the Election

The election of a year-end is made on the T2 tax return of the corporation. Even though the corporate by-laws disclose the fiscal year and the request for Business Number asks for the year-end, a final election is not made until the tax return is filed. There is not a separate form for making the election. The corporation merely states the fiscal year on page one of the T2. The first year-end must be no more than 53 weeks after the date of incorporation. The return must be filed six months after the first year-end (and this includes non-end of month year-ends such as March 15. This return is due on September 15).

Changing the Year-End

Unless you have received approval to change the fiscal year end, the corporation's fiscal year end is the same from year to year.

To change an established fiscal period, write a letter to your tax services office asking for approval and explaining the reasons for the change.

CHAPTER 6

INCOME TAXES

CHAPTER 6

INCOME TAXES

Eventually you will have to deal with income taxes. The income tax laws are extensive and can be confusing for an individual starting a business. This chapter does not cover all the tax ramifications of a new business; however it provides some guidance on complying with the laws. A qualified accountant or tax lawyer should be consulted when you are dealing with income taxes. Income taxes have a direct result and a potentially significant impact on the cash flow of your business.

Income Tax Forms

Each type of legal entity is required to file a different type of income tax form.

Corporation. A corporation is considered a taxable entity and is required to file a Federal T2 form and a provincial tax form as required.

Partnership. A partnership is not a taxable entity. It is treated as a conduit through which taxable income is passed to the individual partners for inclusion in their respective tax returns T1.

Sole Proprietorship. A sole proprietorship is considered to be a component of the individual's personal tax situation. The tax form required is different for each different type of business and becomes a supporting schedule on that individual's T1 return. For example, a professional uses for T2032. These forms are readily found on the CCRA website.

Estimated and Installment Tax Payments

Corporations

Corporations have to pay income tax in monthly installments when the total taxes payable for either the previous year or the current year is more than $1,000.

The balance of tax the corporation owes for a taxation year is due within either two or three months of the end of that taxation year, depending on the circumstances of the corporation.

Interest and penalties apply to late payments. To be on time, you have to make installment payments and other payments on or before the due date either by mailing a cheque payable to the Receiver General for Canada, or by paying directly through a Canadian financial institution.

CCRA considers the payment to have been made on the day they receive it, and not on the day you mail it. Your payment due date may fall on a Saturday, Sunday, or a statutory holiday. If so, CCRA will consider the payment as being received on time for calculating installment interest and penalty, if we receive the payment on the first business day after the due date.

Installment due dates

Installment payments for tax are due on the last day of every complete month of a corporation's taxation year. The first payment is due one month minus a day from the starting date of the corporation's taxation year. The rest of the payments are due on the same day of each month that follows.

Balance due date

Generally, all corporation taxes are due **two** months after the end of the taxation year. However, the tax is due **three** months after the end of the taxation year if the corporation is considered a small business for tax purposes (consult your accountant for this definition).

Individuals

Personal income taxes are due and payable on April 30 of the following calendar year. In most cases this is the filing deadline for T1's with the exception of self-employed individuals who must file their returns by June 15 of that same year (note that even these self employed individuals must pay their estimated tax liabilities by April 30).

Personal Tax Installments

Installments are periodic payments of income tax that you have to pay to cover tax you would otherwise pay on April 30 of the following year. These are paid quarterly on March 15, June 15, September 15 and December 15. CCRA will mail you the forms to make these payments based on your prior year's tax return. You may choose to alter these payments based on expected income taxes payable. However, please consult your accountant before doing so to avoid any unnecessary and unpleasant penalties and interest.

Most people pay their tax by having tax withheld from their income throughout the year. However, if you receive income that has no tax withheld, or does not have enough tax withheld, you may have to pay tax by installments.

This can happen if you receive:

- Rental income;
- Investment income;

- Self-employment income;
- Certain pension payments; or
- Income from more than one job.

Under proposed changes, if you owe more than $3,000 when filing a tax return, you may be liable to remit quarterly in the following year ($1,800 in Quebec). For more detailed information please visit www.cra-arc.gc and search Personal Tax Installments.

Tax Planning

Proper tax planning is essential in order to make the most of the income tax laws. You will probably need to develop a relationship with a qualified professional who has experience with the taxation of your type of business. Tax planning is not a one-time shot right before the return is due. Tax planning is a year-round endeavor requiring communication on both sides – you and your trusted professional accountant. Proper planning ensures that there are no surprises when the return is filed.

Provincial Returns

Only the province of Quebec requires an individual to file a separate provincial return.

Conclusion

Income tax laws are quite complicated. The amount you may save by attempting to tackle your own taxes, particularly as they relate to a business, can be greatly overshadowed by the expense you may incur if you make a mistake. This axiom takes on greater significance when the return is for a corporation. However, a far greater consideration than potential mistakes is missing opportunities, which may be available to you and your business.

CHAPTER 7

CASH PLANNING AND FORECASTING

CHAPTER 7

CASH PLANNING AND FORECASTING

CASH IS KING! The lifeblood of any business is its ability to collect cash and pay bills as well as pay its employees, particularly its owners. Far too often small businesses are profitable, but they do not have enough operating capital to meet their current needs.

Lack of operating capital happens at start up, happens in growth periods and can happen at other times as well. If not addressed directly, it can ultimately force businesses to sell out to a stronger competitor, sell a portion of the company to investors at an undesirable price or close the doors, and put the company out of business. None of these alternatives are typically what the owner's intended when starting the business.

The ability to forecast cash resources and uses is an art and is by no means a well-defined science. None of us have a crystal ball and any cash forecast which the management of a company prepares or an outside consultant can be no more than a guess as to when the customers will pay and when your business will pay its obligations. Hopefully, the more effort that is put into cash forecasting the better will be the educated guess and the more accurate the resultant picture of the future operations of your business.

Starting the Analysis

One of the most significant factors to be considered in your cash flow forecast is the volume of sales, which will be generated, in the next several months and for the rest of the period for which you intend to forecast. Your sales forecast must be as fine tuned as possible. It is typically unrealistic to assume that there is a million dollar market for your product in your area and you will be able to capture a specified percent of it. A sales forecast needs to be based upon specific facts. These might include your sales history or the history of similar businesses you have owned or operated or the competition. In your area of industry, what has been the experience of similar operations?

Consider all the circumstances that impact the sales bottom line. Some of the questions, which should be addressed would include: what other factions can I control such as adding new product lines, deleting unprofitable operations, adding a new salesperson, or terminating one that is not producing to quota? In preparing a forecast, you must also take into consideration items such as the seasonality of your business, the relative state of the economy, and the period over which you forecast.

Obviously your ability to forecast sales for the next month is better than it is to forecast three to five years from now. The amount of detail, which must be included in the cash forecast, is really a matter of preference. It can be based on per-unit sales extended out by the sales price of each

type of unit or an average sales volume per day, week or month of your type of business in its current environment.
Cash Collections

Once you have determined a reasonable level of sales and you are comfortable with the forecast you have made, you must address questions such as:

- What percentage of my sales are received in cash?
- What portion are credit sales for which I will have to carry accounts receivable?
- For those that are receivable based, how soon is the cash collected?
- Do I have to wait for customers to pay me or do third parties such as Visa or MasterCard take the customers account and convert it to cash for me with an appropriate discount?
- If using a gateway for internet based sales such as Moneris or PayPal; is there a discount?

If you are relying on customer payments for collection of receivables you must determine what portion of the receivables will be collected in thirty days, sixty days, ninety days, and thereafter, and what portion, if any, may never be collected. To assume that 100% of your sales will ultimately be converted to cash is probably unrealistic especially considering the current economic environment and the tight cash situations that may face some of your customers.

Other sources of cash may be available in addition to sales. Do you expect to bring in a partner or other investors, or can you borrow money from a bank? When will you receive the cash and how much will you get? Part of your cash flow analysis may be to determine how much investment money or borrowings will be required to operate your business.

Once you are comfortable with the cash receipt side of your business, and the timing of the collections of funds from your sales and other sources, it is necessary to consider the expenses and other cash needs of your business operation.

Disbursements

Certainly if your business entails sales of inventory you will have to purchase the merchandise from others or purchase the component parts and pay employees to assemble it. This may require a significant outlay of cash before the first dollar of sales is generated and received. You should consider how often and in what amount your employees must be paid and when their payroll taxes must be deposited.

Additionally, you need to know the credit trade terms your vendors are willing to advance to you. Do you have to pay for inventory items on a COD basis or can you pay for them thirty or forty-five days after receipt?

What expenses must be paid to allow you to convert purchased merchandise to salable inventory? If your production requires utilities to run machines or supplies that are required such as dispensable chemicals or packing materials that must be purchased prior to the sale of the inventory you should factor the timing of payment.

In addition to the cost of manufacturing, you should consider whether your productive capacity would allow you to generate enough inventories to support the level of sales, which you are predicting. If the volume of sales you forecast is above and beyond your ability to produce today, what changes in your operating environment must be made to meet the production levels. Will you need additional employees, if so, how much will they cost? Do you have to acquire additional machinery for your shop operations? What is the cost of the machinery and when will you have to pay for it?

Once you have determined the cost of operating your production or service facilities, you need to consider what other expenses you must pay to keep the doors of your business open. You typically will have to pay rent for your office or manufacturing facility. You must consider how much the monthly payment is and when it has to be paid. Ask yourself if there will be other cash requirements such as a deposit on the last month's rent. If you are opening a new business, you must consider what your cash requirements are to make your facility ready for your specific needs and purposes. Will you have to buy or rent furniture? Will you need to make tenant improvements or pay deposits for utilities and other services?

You also need to consider many of the overhead items and costs to open a new business that will hopefully be one-time expenses. This may be attorney's fees for drafting partnership agreements or incorporating your business, the cost to obtain business licenses, authorization from the taxing authorities, setting up an accounting system, stationary costs, and costs of signs or logos.

It may seem like the list of costs and expenses to be incurred is endless. It may even discourage you from moving forward with your business endeavor. However, it is imperative to make the list as detailed as possible to ensure that you have sufficient funds to make your operation ready for business prior to running out of cash. The more detailed the list and the more sufficient information you can provide, the less chance there is of unpleasant surprises as you move down the stream to opening your business.

In addition to determining the amount and volume of expenses and cash outlays you will have to make, it is critical to determine the timing of such payments.

As we have discussed in other chapters, there may be a variety of financing alternatives, which are available to you. Most of the start-up costs, which you incur, can be delayed or deferred until you can generate the cash from your operation to help pay them. This needs to be carefully analyzed and factored into your cash flow analysis. However, a good rule of thumb is to assume that you are going to have to pay your expenses sooner than you think and that you will collect your cash slower than you anticipate. If you work with this attitude, any surprises should be favorable ones.

Cash flow projections can be very slow, time consuming, and tedious to undertake. It is often very tempting to hire someone else to prepare the projections for you. There are a variety of individuals who can help you do this, but the critical factor is that they only **help**. You as the owner and operator of the business are the only one truly qualified to develop your cash flow projections. You know what it takes to open and operate your business. Certainly a trained professional can offer guidance and ask pointed questions to be sure you are considering all of the necessary and sometimes hidden costs of operating a business. However, the more effort you put into developing the cash flow projections the more accurate they will tend to be. This exercise may also help you to pinpoint areas of potential cash savings, which you had not otherwise considered.

We have included a worksheet following this chapter, which may assist you in developing a cash flow analysis. Bear in mind however, this worksheet does not include all the items that should be considered in preparing **your** cash flow analysis but should help raise many of the questions which you need to ask yourself before deciding how much cash will be required to establish and operate your business and what period of time must elapse before you can expect to pay back the lender or return profits to your investors.

PROJECTED STATEMENT OF CASH FLOW
(for one year)

	Projected Quarter Ending			
	1st	2nd	3rd	4th
Net income				
Add (deduct) items not requiring cash:				
Depreciation				
Net Cash Provided				
Increase (decrease) in cash:				
Accounts receivable				
Inventory				
Property and equipment				
Accounts payable				
Accrued income taxes				
Preferred stock				
Increase (decrease) in cash				
Net change in cash				
Cash beginning of period				
Cash end of period				

CHAPTER 8

OBTAINING CREDIT
AND
FINANCING FOR YOUR BUSINESS

CHAPTER 8

OBTAINING CREDIT AND FINANCING FOR YOUR BUSINESS

If you are not independently wealthy and perhaps even if you are, eventually you will probably need to obtain some outside capital for your business. In some instances, you may need to obtain capital for the initial expenses prior to opening your business or for instance, the funds you require may be for expansion or working capital during the off season.

Generally business financing can take two forms, debt or equity. Debt, of course, means borrowing money. The loans may come from family, friends, banks, other financial institutions or professional investors. Equity relates to selling an ownership interest in your business. Such a sale can take many forms such as the admitting of a partner or, if you are in a corporation, issuing additional common stock, options or warrants to investors. It is typically a prudent idea to consult with your lawyer, as there are many significant legal ramifications to such a step.

How Do I Get the Money?

Irrespective of the type of financing you need and are able to obtain for your business, the process of obtaining it is somewhat similar. There are several questions that must be answered during the course of raising money for your business. The ability to answer these questions is critical to your success in obtaining financing as well as the overall success of the business. Remember, in raising capital you have to sell the ability of your business to potential investors in much the same way as you sell your product to your customers.

You need to know the answers to these questions:

1. **How much cash do I need?** To answer this question you will have to do some serious cash flow planning, which will require estimates of future sales, the related costs, and how quickly you must pay your vendors. You will also have to factor into your planning some assumptions about when you will generate enough cash to pay the money back. However, if you raise cash through equity you probably don't need to pay it back but your co-owners will want to know how the value of the business will grow and how they will benefit through dividends or selling their shares.

2. **What will you do with the money?** One of the most important questions you will have to answer for a potential investor is how the money will be spent. Will you use it for equipment or to hire additional employees or perhaps for research and development for a new improved product? Again, part of the answer on how you spend the money is how it will benefit the company.

3. **What experience do you have in running your business?** One of the primary reasons for business failure is lack of experience and management. You will need to convince your investors that you have the knowledge, experience and ability to manage your business and their money at the level at which you expect to operate.

4. **What is the climate for your type of business and your geographic location?** Few investors will want to put money into your business if you have not done sufficient "homework" to determine that you have a reasonable chance of success. If your business is based on existing economic or legal conditions, which are subject to change, in the near future your risk is substantially increased. Even if your business has great potential, if the local economy is sluggish to the point that it can not support your venture, you need to be aware of this before moving ahead.

Once you have developed concrete answers to these and other pertinent questions, you can begin investigating financing options. One of the first steps is to determine whether to raise funds through debt or equity. There are positive and negative aspects to each type of capital. The cost to your company of each type of funding is different as is the way in which they are treated for income tax purposes.
The interest on borrowed money is deductible by a business for income tax purposes, which reduces the effective cost to your company. Dividends, which you might pay on the same investment in stock, would typically not be tax deductible by your company. In selling stock there usually is no firm commitment by your company to pay the money back but your stockholder will want and generally will have a legal right to have a voice in the management of your company. When you have made the decision as to the type of financing you think is appropriate to fit your desires and needs it is probably a good idea to consult with your accountant as to alternative types of debt or equity financing available.

Financing Alternatives

Whether you determine that debt or equity financing is the best choice for your company, there are a number of alternative types of financing available. Depending upon the nature of your business the financing may be a combination of debt and equity and may be tailored to fit the specific needs of your company.

In conclusion we will only mention a few of the more conventional methods for a young company to obtain capital, though the possibilities are many. A good business oriented accountant can discuss these and other alternatives in greater detail.

Debt Financing Sources

Banks. The first source of funds, which typically comes to mind when borrowing money, is a bank that is why they are in business. Banks typically lend to small businesses on a secured basis using equipment, inventory or accounts receivable. The more liquid and readily salable the assets you have to offer as security the more acceptable they are likely to be to a banker. Loans from a bank may take several forms such as:

1. A line of credit which renews annually and allows you to borrow up to a predetermined maximum as you need it and pay it back as funds from sales and receivables are collected.

2. A short-term demand note which is payable in full on a specified date.

3. A term loan for the purchase of a specific asset such as a computer, vehicle, equipment ,etc,

4. Long-term (3-5 years) loan: repaid in monthly installments.

Lease financing. In today's business environment it is quite common to acquire equipment through lease agreements. Leasing packages come in a variety of types through many sources. Leasing companies typically will accept a somewhat higher degree of credit risk because they are looking to the value of the equipment for collateral if your business cannot make the agreed upon payments. For this reason, leasing companies generally prefer to finance new equipment of a general-purpose nature, which can be resold if necessary. Leases often run for a period of three to five years and because of the risk that leasing companies are willing to take, they are somewhat more expensive than commercial bank loans.

Trade credit. A very important source of financing for your company may be from the vendors and suppliers with whom you do business. Many suppliers will originally ask for cash on delivery or in some instances they want payment before starting on your order, depending on the nature of your purchase. Most suppliers will quickly establish trade credit with you once you have gained their confidence by continuing to do business with them and paying as requested. Establishing good relationships with trade creditors is essential because it allows you to use the goods and services in your operations and sell your product to your customers, in some instances before you pay for them. Other vendors will rely upon the trade credit you build today as you attempt to establish yourself with other vendors in the future. Trade credit terms will vary depending on the type of purchase you make, the supplier's industry, and the industry you are in.

Equity Financing Sources

Equity financing usually means selling a portion of your business. This can be accomplished in a number of ways including the sales of common or preferred stock or stock warrants. Equity sales are usually carefully tailored to meet the needs of both the company and the investor.

Venture capital companies. A venture capital company or fund is typically a company that is in the business of taking risks. A venture capital fund is often backed by a group of investors, which may be individuals or corporations. The investors are often represented by a management group, which evaluates potential investments and manages the existing investment portfolio.

The price of venture capital financing is usually very high when compared to borrowing money from a bank, but it must be remembered that venture capitalists are dealing with much higher risk situations than commercial banks will finance. This cost of venture capital is measured in terms of the portion of your company you must sell to obtain the level of financing you require. A venture capital firm sometimes requires a 300 to 500 percentage return on its investment over a four to five year investment period. While this may seem like an enormously high return, a venture capitalist is in the risk business and the return on a good investment must help offset those companies that do not meet their projections or fail altogether. To determine the price of such financing, a venture capitalist will start with the amount of financing you require and calculate what they must receive at the time the investment will be sold to allow them to achieve the necessary rate of return.

Based upon the operating projections you provide, discounted based on their experience, they will estimate what your company might be worth at the time the investment will be liquidated. This might be at the point of a public offering or a sale to a corporate investor. The last step for a venture capital company in determining pricing is to calculate what percentage of the company they must own to realize the return desired. At this point, the "horse trading" generally begins. As a general rule you will want to retain as much of the ownership of the company as you can. The venture capitalist wants enough ownership to achieve the investment goals and have some control over how the money is spent. This will often be achieved by voting power and representation on the Board of Directors. At the same time a venture capitalist wants to be sure there is sufficient reward in the company for you and your management team to be motivated and achieve the projections in your business plan.

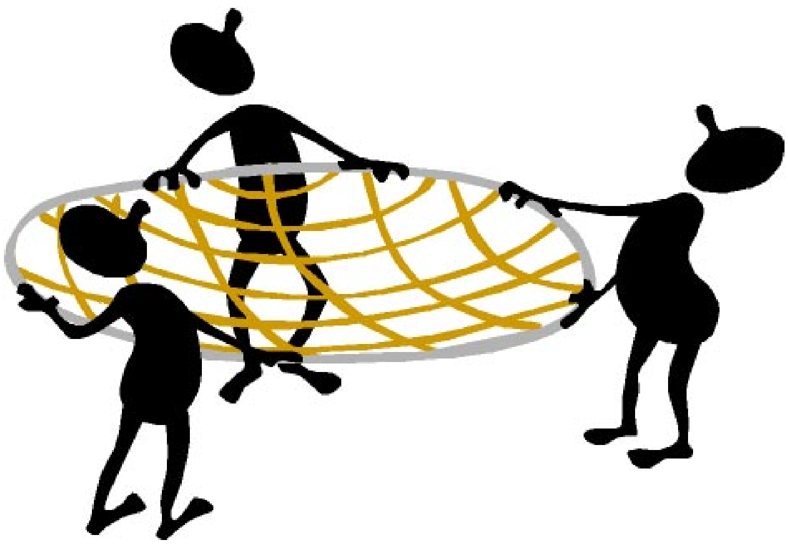
An individual or group of individuals often manages a venture capital company with a strong background in business and management. They can often provide depth of experience and management assistance in areas where your management team may be weak. A venture capital group can very often provide contacts and valuable introductions in your industry. Remember a venture capital investor becomes a member of your team.

Private individuals. Very often, individuals who are successful in their own right and have accumulated substantial wealth may be looked to for investment in your business venture. Such individuals may believe that the success of your business may enhance theirs as well as help increase their personal wealth. These individuals, like a venture capital company, very often want to participate in the management activities of your firm and help guide your progress through representation on the Board of Directors. The business acumen and contacts of these individuals can often be a valuable asset of your business. An individual investor can often react to opportunity much quicker than a venture capital firm and typically has only their own interests to serve as opposed to a financial backer or group of investors.

Individual investors can be more flexible in the type of investment structure they can deal with, and often have personal, financial and tax motivations to consider.

CHAPTER 9

INSURANCE



CHAPTER 9

INSURANCE

Business insurance, like many types of expenditures is one of those items, which business owners typically do not like to pay. You must remember that sufficient insurance can be as critical to the success of your business as a good product or service. Without proper insurance you could lose all of the money, time and effort you put into your company. The types and amounts of coverage you purchase must be evaluated on a cost-benefit basis like any other commodity, which you purchase. Your accountant and insurance agent can help you review the amount of coverage you may wish to purchase for various purposes. Usually, you will want to insure against risks, which could have significant detrimental impact on your business. This normally would include such items as fire, storm damage, theft, general, and product liability.

Depending on the nature and size of your business it is often a good idea to self-insure for all or a portion of certain losses. Not buying coverage for incidental risks or increasing the deductions on policies, which you do buy, can accomplish self-insurance. Often, raising the deductible can have a very favorable impact on policy premiums. The administrative cost to the insurance company to process small claims is quite high; consequently the rates typically go down substantially if they are relieved of this expense by insuring for losses in excess of a sizable deductible amount. An insurance broker can provide you with comparative costs for various types of coverage with varying degrees of deductible amounts.

Required Policies

Very little insurance coverage is mandatory. The only insurance coverage typically required by law is worker's compensation, which covers injuries to employees while on the job. Your insurance agent can explain the required coverage, the rating systems, and help you purchase a policy.

You must also be aware that the terms of your building, office lease or mortgage may require you to carry certain kinds of insurance coverage in specified minimum amounts. If you have leased equipment or have borrowed money from a bank or other lenders, there will usually be insurance requirements in the agreements relating to these transactions. There are many other types of policies, which you may wish to consider. The specific coverage provided by each and a qualified insurance broker can explain the related costs in depth.

Some of the types of insurance coverage, which you might consider for your business, are listed below:

Business Interruption. This coverage, as the name implies, covers the loss of revenues your business would generate if you were forced to shut down for reasons beyond your control. While this is obviously valuable insurance, the policy premium must be carefully considered relative to the potential profits your business might lose during a short shutdown of operations.

Employee Fidelity Bond. This type of insurance typically covers the risk of loss from theft by employees. If your business deals in large amounts of cash, negotiable securities, or similar types of assets, you may be well advised to consider this coverage. Certain industries are required to carry this insurance by regulatory authorities.

Umbrella Coverage. This type of insurance covers losses above and beyond the limits of other policies, which you carry. Umbrella policies usually pertain to liability of various sorts and are usually valuable if your business or you have a net worth, which requires protection in the event of a catastrophic loss.

Insurance is like any other product, which you purchase. Before purchasing it you should consult with more than one broker as to your needs for protection. You should discuss insurance needs with acquaintances in the same or related business as yours. Before buying coverage you should check out the reputation of the company that is underwriting the policy. The provinces regulate insurance companies and each province will provide you with the information you require to make an informed decision.

CHAPTER 10

SELECTING PROFESSIONAL ADVISORS

CHAPTER 10

SELECTING PROFESSIONAL ADVISORS

Starting your own business obviously entails a multitude of decisions; decisions which can seem overwhelming without the right players on your team. In order to succeed you need to equip yourself with every tool at your disposal.

One of the most cost effective tools you can utilize is the expertise of a specialist. The right accountant and lawyer can eliminate a host of problems and potentially costly errors you might make as you build the financial foundation of your successful business.

As any coach can tell you, having a first rate quarterback (you) will not guarantee a winning team without a first rate line of defense. The right accountant and lawyer are your best defense. Their expertise can help save you money, which in turn can be used to increase profits.

When enlisting the expertise of an accountant and lawyer you want a specialist suited to meet your specific needs. You want a specialist who will listen to you. More importantly, you need someone you can and will listen to as they devise strategies to help you succeed.

You want to succeed – and you can. By taking the time to make key decisions and enlisting the right players on your team – you will succeed!

We wish you success and welcome you to the wonderful world of free enterprise.

CONCLUSION

You now have a handy reference guide to starting a business. With it you should be able to successfully handle many of the problems encountered in starting and running a business. Always remember to seek professional advice in areas in which you are not sure. The benefit will far outweigh the cost.

Best of luck on your venture!