

## **Essential tax tips for the self-employed**

### **Self-employed need to keep careful track of income and expenses**

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Taxing Issues

Published Tuesday June 5th, 2007

Appeared on page C2

Today we continue our series for the self-employed. If you earn income from a business you have started yourself, you must prepare an income statement each year, showing all the income and expenses of your business. The resulting net profit or loss is then transferred to your tax return and is taxed, along with all your income from other sources.

The Canada Revenue Agency (CRA) provides standard business statement forms, which it encourages you to use in calculating your profit and loss. The form number is T2124.

As a small-business owner, you are entitled to deduct the ongoing costs of doing business, so long as the expenses are reasonable and have a profit-producing motive.

It is important to have a good record-keeping system since it is inevitable that you will have forgotten about certain expenses that you incurred when tax time come around. Every dollar of expense that you overlook is one more dollar added to your taxable income, so don't trust your memory. Instead, write it down, and save those receipts.

Some of the more common deductible expenses include advertising, promotion, rent, salaries (not including your own), legal and accounting fees, and auto expenses. The cost of advertising with Canadian media is deductible, as are the cost of flyers, brochures and other promotional activities. This includes the cost of entertainment and business lunches, if used to promote your business to existing or prospective clients.

However, unlike advertising or promotion, only 50 per cent of the cost of meals and entertainment is deductible. While office rent paid to a third party is deductible, if you own your business premises, or run your business out of your home, you may not deduct the rental value of these premises. Instead, you may deduct any related expenses, such as mortgage interest, property taxes and insurance. These expenses must be pro-rated if part of the building is used for personal purposes.

Salaries, wages and benefits paid to employees are deductible in full, as are the employer-paid premiums for the various government programs. Salaries and wages paid to your spouse or child are deductible, if the work done is necessary for earning business income, and the amount paid is reasonable, or equivalent to what you would have paid an unrelated person for the same type of work.

However, salaries drawn by you, the owner, are not deductible and shouldn't be included on the income statement. Fees for outside professional advice or services are deductible, including consulting fees, bookkeeping and accounting fees, and tax return preparation fees.

Legal fees incurred for the purpose of earning business income are deductible. These include fees paid for legal advice related to on-going business activities, or to a collection agency for the collection of bad debts. Many people are surprised that legal fees incurred to buy capital property are not deductible. Instead, these are added to the capital cost of the property.

While business taxes and annual business licenses are deductible, fines and penalties for infractions of public laws are generally not.

Automobile expenses related to earning business income are deductible. If the vehicle is used only partly for business, the expenses must be pro-rated between business and personal use based on the relative number of kilometres driven.

We are often asked on whether it is better to purchase or lease. This is truly a matter of personal preference, as some people like the feeling of ownership. If you are in this category, you may deduct any interest on the car loan and claim the capital cost allowance (often referred to as depreciation) on the vehicle. On the other hand, leasing provides an opportunity for someone to drive a new vehicle every few years and to deduct as an expense the cost of the monthly lease payment. These amounts are subject to limits under either method and are based on the ratio of business to personal driving.

You may not deduct the cost of other capital expenditures either, such as a new filing cabinet or computer system. Like vehicles, such expenditures normally supply a long-lasting benefit. Therefore, tax law requires that the expenses be deducted slowly, over a period of years. Rates of depreciation differ based on the normal useful life of an asset.

Income and expenses from a business are calculated on a fiscal-year basis, which - because of a change in the law in the mid-1990s -- usually coincides with the calendar year, as the income deferral possibilities are more limited.

Finally, it is important to note that any business loss is deductible against other income. So if your new business is a supplement to a regular job, you may find yourself with larger-than-usual refunds during the first couple of years of the venture.

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