

INCOME OR LOSS FROM A BUSINESS

Business Income

- Business income is calculated using the accrual basis of accounting; however, income for tax purposes does not usually equal to net income under GAAP (IFRS or ASPE). Therefore, we need to make adjustments (additions and deductions) to accounting income to arrive at business income for tax purposes.

Going from Accounting Income to Business income for tax purposes

Starting Point: Net Income per Financial Statement (i.e. Accounting Net Income)

Add the following back to Accounting Income:

1. Income Tax Expense on the financial statements (current and future tax expenses)
2. Accounting Amortization and/or depreciation
 - For tax purposes we need to use the Capital Cost Allowance (CCA) rates
3. 50% of meals and entertainment
 - 100% of the meals and entertainment is allowed to be deducted where
 - i. All employees at a location (office) participate (i.e. office parties): limit of 6 per year; or
 - ii. The proceeds of an event benefit a charity (i.e. charity banquet); or
 - iii. The taxpayer is in the business of providing food (i.e. restaurant)
4. 100% of accounting losses
 - This is added back because
 - i. accounting loss = proceeds less net book value, while allowable capital loss = 50% * (proceeds – adjusted cost base)
 - ii. Only 50% of capital losses are allowed to be deducted for tax, and only against taxable capital gains
5. Net Taxable Capital Gains
 - Net means...Taxable Capital Gains less Allowable Capital Losses
 - This cannot be a negative number
6. Recapture on the sale of depreciable capital properties (see CCA notes)
7. Recapture on the sale of eligible capital properties (see CCA notes)
8. Interest and penalties paid to the CRA – are not allowed to be deducted for tax purposes
9. Government Fines and Penalties – are not allowed to be deducted for tax purposes
10. Donations (get a credit if individual and division c deduction if corporation)
11. Political Donations (you get a credit for this later)

12. Automobile expenses in excess of the maximum prescribed amounts
 - 53¢ per kilometre for the first 5,000 kilometres driven; and
 - 47¢ per kilometre driven after that.
13. Prepaid Expenses (for services to be done after the end of the year)
14. Club Membership Dues and Recreational Facilities Fees – are not allowed to be deducted for tax purposes
 - yachts, camps, golf course,
 - club memberships that provide dining, recreational or sporting facilities for members
15. Accrued Bonuses that remain unpaid after 180 days from the year end it was declared
16. Contingent Expenses – are not allowed to be deducted for tax purposes
 - Warranty Expenses
 - Provisions for lawsuits
 - Provisions for inventory (tax act uses lower of cost or market rather than lower of cost or NRV)
17. Advertising Expenses if you advertised in a foreign media, and the advertising is directed towards the Canadian Market
 - If a Canadian company advertised in the Economist Magazine and their target is to reach the Canadian readers of the magazine; they will not be able to deduct the expenses. However, if the advertisement is targeted towards Americans, then the advertising is allowed to be deducted.
 - The government put this in the tax act to encourage Canadian businesses to use domestic media to advertise to Canadians
18. Life insurance premiums not required as a collateral for financing
 - Usually lenders require the company to take a life insurance policy on key executives
 - “life insurance” premiums not required by a creditor as a collateral for a loan is not deductible for tax purposes
19. Bad Debt Expense on the Financial Statements
 - For tax purposes, the increase or decrease to the bad debts reserve is done on an **“account-by-account” basis** such that if CRA asks for support you can provide them with correspondence that you had with the debtor and an aged trial balance
20. Reserves Deducted in the previous tax year
 - Reserves taken last year is always added back; and the current year’s reserves are then deducted (see below under deductions)
 - Examples
 - i. Bad Debt Reserve
 - ii. Capital Gains Reserve
 - iii. Reserve for amounts unpaid
21. Accounting and legal cost of issuing debt or shares
 - We are able to deduct 1/5th of this amount below (see below)
22. Illegal payments
23. Unrealized accounting losses (write-downs)

- For example, certain financial instruments under ASPE and IFRS need to be restated to fair value
 - Impairment losses are also unrealized
24. Commission expense or legal expenses paid on the purchases of investments – are not allowed to be deducted for tax purposes
 25. Personal or living expense (all non-business related expenses are not deductible)
 26. Excess interest and property taxes on vacant land
 - You can only deduct interest and property taxes incurred on a vacant land only up to the revenues earned by the vacant land
 - You cannot create a loss on a vacant land with interest and property taxes
 27. Expenses that are not reasonable
 - I.e. salary to spouse, when the spouse has not done enough work to warrant such an amount

Deduct the following back to Accounting Income:

1. Capital Cost Allowance (see CCA notes)
2. Cumulative Eligible Capital Amount
3. Accounting Gains
 - Accounting gains \neq taxable capital gains
4. Terminal Losses (see CCA notes)
5. Landscaping costs that were capitalized (not expensed) for accounting purposes
6. 1/5th of legal and accounting expenses incurred on the issuance of shares or debt
7. Reserves for the year
 - i. Bad Debt Reserves (account-by-account basis)
 - ii. Capital Gain Reserves
 - iii. Reserve for unpaid amounts
8. Unrealized accounting gains (accounting write ups)
 - For example, certain financial instruments under ASPE and IFRS need to be restated to fair value
9. Deduct the following if they have not been expensed for accounting purposes
 - a. Employer contribution to a deferred profit sharing plan
 - b. Cancellation of lease
 - c. Expenses of making a representation to the government to obtain a licence, franchise, patent, permits, or trademarks
 - d. Site investigation costs incurred while investing suitability of a site or building
 - e. Utilities service connection – to make service connection to place of business by way of wires and pipes for gas, electricity, water, etc.
 - f. Disability related modifications to buildings and equipment (so that people with disabilities can use it)

- g. Scientific Research and Experimental Development costs (both current and capital expenditures can be deducted for tax purposes)
- h. Convention Expenses (you can claim a **maximum of attending 2 conventions** per year)
 - i. *a corporation which has diversified business interests and many employees may take the limit of two conventions per year to apply to each such interest. For example, a large integrated oil company might be interested in conventions of personnel people, accountants, chemists, geologists, and other groupings and the limit would be applicable separately to each interests. These taxpayers may claim more than 2 conventions.*

∴ Accounting Income + Additions – Deductions = Business Income for Tax Purposes (i.e. Division B Business Income)