The Ultimate Guide to

INCORPORATED SMALL BUSINESS IN CANADA

UPDATED FOR 2022/2023

FBC

Making Sense of Your Corporate Obligations

Many incorporated business owners feel intimidated by the demands of tax season and the corporate filing requirements of the Canada Revenue Agency (CRA). This is completely natural.

While there are numerous benefits to incorporation, it also comes with three serious obligations: filing an annual return, filing your T2 tax return, and keeping your minute books up to date. The complexity and administrative burden of these requirements leave many businesses struggling to keep up.

That's why we've created this guide—not just to help you get organized ahead of tax season, but to help you:

- **Understand your financial and administrative responsibilities as a corporation**
- **Take full advantage of the benefits of incorporation**
- **Learn more about commonly missed and misunderstood tax credits and deductions**
- **Determine if this is the right structure for your business**

About FBC

For more than 70 years, we have worked with tens of thousands of farm and small business owners across Canada. We optimize their tax returns, maximize their tax savings and support their back office needs with bookkeeping and payroll. Our legal services including minute book filing and annual returns.

Disclaimer: This material is provided for educational and informational purposes only. Always consult a tax specialist, like FBC, regarding your specific tax situation.

UNDERSTANDING CORPORATE BUSINESS STRUCTURE

What's a corporation?

A corporation is a formal business arrangement that brings into existence a legal entity separate from you and your personal assets. For this reason, being incorporated can provide small business owners in Canada with the most tax and liability advantages.

When should you incorporate?

Regardless of the business structure you start with, as your business grows, the time will come when you'll want to consider incorporating. This usually happens when the business is generating surplus profits and you, as the business owner, have more revenue than you need to cover personal expenses. By incorporating, you can leave surplus profit in the business, allowing you to defer personal taxes on the withdrawals.

Other reasons include:

- When the tax benefits of a corporate structure outweigh the costs and extra administrative requirements of using the structure. Paying less tax is often a primary motivator for incorporation, but only take this action when other costs don't offset those gains.
- When the debt servicing of a business demands a large portion of profits. This strategy allows you to shield a portion of profits used to repay principal from rates of tax.
- When you want greater planning flexibility upon the closure or sale of your business. In the event of asset liquidation, when wrapping up the business, corporate tax rates can be preferable to graduated marginal personal rates.

Choosing the right structure for your business

Most small businesses start out as a sole proprietorship, but there are actually three main business structures in Canada. Each one has its own advantages and drawbacks:

- Sole proprietorship
- Partnership
- Incorporation

Sole proprietorship

This is the most basic business structure. One person owns the business and makes all the decisions, keeps all the profits and assumes the risks of the business.

As a sole proprietor, the Canada Revenue Agency views the business and owner/operator as being one and the same, which means you are personally liable for the business. This means if a creditor files a claim against the business, they can go after your assets—whether they're business or personal.

As a sole proprietor, income is taxed at your personal rate. If the business is having a bad year, you can deduct the losses from your personal income, which lowers your tax bracket. At the same time, if you're having a good year, you could be put into a higher tax bracket which can cut into your profits. This model also has limited life in that when the owner dies, the business dies as well.

Advantages	Drawbacks
✔ Lower start-up costs	✕ Unlimited liability
✔ Easy to form and dissolve	✕ Limited life
✔ Fewer regulations	✕ Increased difficulty raising capital
✔ Ownership of all profits	✕ Income taxed at higher personal rate
✔ One individual income tax return	✕ Business/personal expenses

Partnership

A partnership is a non-incorporated business that is formed between two or more people. You and your business partner(s) choose how to divide the profits and are equally liable for debts or legal action taken against the business.

Like a sole proprietorship, a partnership has no legal structure. However, it's recommended partners have an agreement that stipulates how the business is structured, with regards to revenue, profits, expenses and liabilities. This is beneficial come tax time, as each partner understands what percentage of income and expenses applies to them.

There are two types of partnerships: a general partnership and limited partnership. With a general partnership each partner is responsible for the debts. In a limited partnership, one of the parties can be a partner but not directly involved in its day-to-day operations. The most common limited partnerships are formed by a group of professionals, such as doctors, lawyers and accountants.

As a result, each partner is generally responsible for filing their own income tax return and claiming the agreed upon share of the partnership's profits or losses. However, there are cases where a partnership may have to file a tax return—for example, if the partnership makes over a certain amount of money or if the partnership is formed by a group of professional (ie. lawyers, accountants, etc.).

Most people considering a business partnership think it's a good idea to consult a lawyer to help draw up the agreement. However, it's important to understand that lawyers are generally not experts on taxes. If you're thinking of drawing up a partnership agreement, contact tax professionals to understand the tax implications before you commit.

Advantages	Drawbacks
✔ Simple to form and dissolve	✕ Unlimited liability
✔ Power in numbers	✕ Income taxed at higher personal rate
✔ Lower start-up costs	✕ Limited life
✔ Fewer regulations	✕ Possibility of disputes/conflicts
✔ Individual tax returns/tax rates	

Incorporation

Unlike a sole proprietorship or partnership structure, a corporation is its own legal entity that in most cases provides the owners protection from liability.

It also carries the advantage of lower tax rates, which can save you a lot of money. However, there can be higher administrative costs due to set up fees, more paperwork, or the need to enlist the help of professionals to handle more complex tax filing requirements. Evaluating your business and personal goals against the costs, both financial and investment of time, can help you decide if this structure fits your needs.

Advantages	Drawbacks
✔ Limited liability ✔ Extended life ✔ Income tax deferral ✔ Transferring the business ✔ Income control ✔ More opportunities to raise capital ✔ Business name protection ✔ Lifetime capital gains exemption ✔ Income splitting (in certain circumstances)	✕ Expensive ✕ Additional tax return ✕ Increased paperwork (additional tax returns, an annual incorporation return, articles of incorporation, notifications for changes, and minute books) ✕ No personal tax credits ✕ Less tax flexibility ✕ Liability may not be completely limited (exceptions include personally guaranteed loans, government tax obligations and payroll deductions) ✕ Closing is more difficult

IS INCORPORATING WORTH IT?

As with any business decision, you must weigh the pros and cons when it comes to incorporating your business. In this next section, we give you the information to help you do just that.

The two biggest benefits of incorporation

1) **Limited liability to protect personal assets:** The most important benefit of incorporation is the protection it provides by limiting the liability of the owners, or what they are responsible for under the law. Since a corporation is its own legal entity, it pays taxes, incurs debt and can be even be sued. However, in most cases, your personal assets are protected against creditors or if legal action is taken against the business (talk to a tax specialist about exceptions). This means that incorporating can help shield you and, by extension, your family from financial harm.

   While the liability of the corporation does not generally extend to you personally, it is important to understand that there are certain situations, such as if a corporation owes GST/payroll amounts to the CRA, where the directors can be held personally responsible for payment.

2) **Low tax rates:** Businesses that operate as sole-proprietorships or partnerships generally pay a higher personal income tax rate on profits as opposed to incorporated business.

   For example, if your income hits $250,000, your personal tax rate might average out to 33% federally. The federal tax rate for incorporated businesses earning active income is 15% and could be as low as 9%. Applicable provincial tax rates would also apply.

   It’s easy to see that incorporating a business could help save you a significant amount of money in tax.

A closer look at corporate versus personal taxes

Personal income tax rates

In 2022, personal income is taxed as follows:

- 15% on the first $50,197 of taxable income, plus
- 20.5% on the next $50,195 of taxable income (on the portion of taxable income over 50,197 up to $100,392), plus
- 26% on the next $55,233 of taxable income (on the portion of taxable income over $100,392 up to $155,625), plus
- 29% on the next $66,083 of taxable income (on the portion of taxable income over 155,625 up to $221,708), plus
- 33% of taxable income over $221,708

Small business corporate tax rates

Incorporated business either make money from the things they actively sell, or the investments they make.

Canadian controlled private corporations (CCPC) can take advantage of the small business tax deduction. This allows them to pay a lower federal tax rate on the first $500,000 of active business income.

Businesses that hold in excess of $50,000 of passive investment income will see a reduction in the amount that their active income is eligible for the small business tax rate.

2021 Corporate Income Tax Rates

	Active Business Income			Investment or Passive Income*
	General	Small Business	Business Limit	
Federal	15%	9%	$500,000	38.7%
Alberta	8%	2%	$500,000	8%
British Columbia	12%	2%	$500,000	12%
Manitoba	12%	0%	$500,000	12%
New Brunswick	14%	2.5%	$500,000	14%
Newfoundland & Labrador	15%	3%	$500,000	15%
Nova Scotia	14%	2.5%	$500,000	14%
Northwest Territories	11.5%	2%	$500,000	11.5%
Nunavut	12%	3%	$500,000	12%
Ontario	11.5%	3.2%	$500,000	11.5%
Prince Edward Island	16%	2%	$500,000	16%
Quebec	11.5%	4%/3.2%	$500,000	11.5%
Saskatchewan	12%	0%	$600,000	12%
Yukon	12%	0%	$500,000	12%

** Applies to CCPCs and excludes capital gains and dividends received from Canadian corporations.*

2022 Corporate Income Tax Rates

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Manitoba	12%	0%	$500,000	12%
New Brunswick	14%	2.5%	$500,000	14%
Newfoundland & Labrador	15%	3%	$500,000	15%
Nova Scotia	14%	2.5%	$500,000	14%
Northwest Territories	11.5%	2%	$500,000	11.5%
Nunavut	12%	3%	$500,000	12%
Ontario	11.5%	3.2%	$500,000	11.5%
Prince Edward Island	16%	1%	$500,000	16%
Quebec	11.5%	3.2%	$500,000	11.5%
Saskatchewan	12%	0%	$600,000	12%
Yukon	12%	0%	$500,000	12%

What's the difference between active and passive income?

Active income – good and services

Income you actively earn, through selling goods or providing services is generally considered "active business income."

Active business income does not include investment income, income from a specified investment business, or income from a personal services business.

Passive income – investments

Passive income usually comes from investments, like ownership of capital property or assets that generate income without excessive effort on the part of the stakeholder. It can come from interest, capital gains, rent, royalties, and dividends. Most of the time, passive income is considered taxable income in Canada.

It's always important to talk to a tax professional about passive and active income, and how to account for them on your books and tax filings.

Additional benefits of incorporation

Income tax deferral: Surplus profit can be reinvested back into the business or used for other investments, allowing you to defer taxes.

If you do not need to withdraw all of the income that your business earns for your personal use, you can defer personal taxation on that income by leaving it in the corporation until it is required. The period that the funds are left in the corporation creates a deferral in tax (i.e. not paying tax today and instead paying tax in the future when the money is withdrawn).

Transferring your business: Greater flexibility for your exit strategy and transferring operations to the next generation. For example, you can make your children shareholders and gradually increase their stake in the business.

Income control: Multiple options for determining the most tax-efficient way to pay yourself—dividends, salary, bonuses or a combination.

More opportunities to raise capital: The corporation can issue bonds, sell stocks and borrow from banks and lenders.

Lifetime capital gains exemption (LCGE): This could reduce taxes due on capital gains arising from the disposition of certain properties (small business corporation shares and qualified farm and fishing properties).

Extended life: The corporation continues as an independent entity after you pass on.

Shareholder loans: Shareholders may use corporate funds for personal uses throughout the year, outside of the traditional salary or formal dividend arrangements.

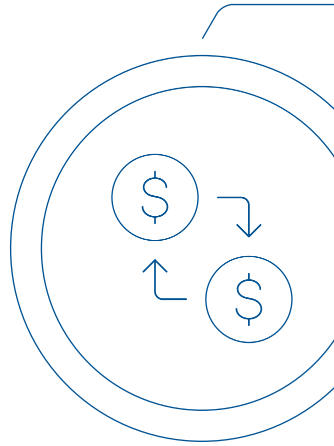
Income splitting: While the introduction of the TOSI rules reduced many income splitting opportunities, if your business is incorporated, there are still situations in which dividends can be paid to certain family members to effectively income split. This strategy offers greater flexibility to an incorporated business since the dividends paid can vary from year-to-year, as can the recipients receiving them.

You must first set up your incorporated business to include your spouse and/or children as shareholders. Note, this doesn't have to be done at inception of the corporation, with proper tax planning strategies and the help of a lawyer, you can amend shareholders throughout the year.

Note: Shareholders do not have to be employees to receive dividends. But employees can be shareholders and receive both a salary and dividends through the business.

There are additional income splitting strategies available to Canadian taxpayers but you should consult with a tax professional to determine if they're right for your situation.

Drawbacks to incorporating a small business



Cost: There are always going to be some drawbacks to any business structure. In addition to the initial set up fees, an incorporated business needs to file a separate tax return (called a T2) to make sure it is complying with corporate regulations. The return can be very complex and filing it generally requires professional help.

Losses remain with the business: If your business loses money in the first year or two, those losses stay with the company—you cannot claim those losses personally.

That said, you can carry those losses forward into future years to deduct against future profits within the corporation.

Additional paperwork and administrative burdens: There is a lot more paperwork involved when your small business is incorporated. As noted above, there is legal paperwork that needs to be filled out each year, including an annual return, corporate tax return, minute books, financial statements to distribute to shareholders (some exceptions apply). This will cost time and money.

Most incorporated business owners understand in principal that they must file a tax return each year—even though they may require professional help to do so. It's the annual return and minutes books that are often neglected or forgotten until it's too late.

Annual return

What's an annual return?

Despite having a similar name, an annual return is different from an annual tax return. It is a corporate law requirement that lets Corporations Canada know that your business is "active"—essentially, that you're still in business.

Regardless of the size of your corporation, you are obligated to file an annual return if your corporation's legal status is "active" (that is, not dissolved, discontinued, or amalgamated with another corporation).

If you do not file or file late, you will not receive a "Certificate of Compliance" from Corporations Canada.

What does a Certificate of Compliance do?

A Certificate of Compliance is often needed to support a loan request or to provide assurance to a potential investor that a corporation has not been dissolved.

What's included in an annual return?

Your annual return can be filed online. To file you need:

- The date of your last annual meeting
- Your type of corporation: private or public
- To be a director, officer or authorized individual who has relevant knowledge of the corporation and is authorized by the directors

An annual return is not your income tax return and is separate from any filing obligations you may have with the CRA.

Annual return filing deadlines

Every incorporated business must submit an annual return every year to Corporations Canada within 60 days of its anniversary date.

The anniversary date is the month and day on which the corporation was created or the date on which the corporation first came under the jurisdiction of the Canada Business Corporations Act.

You do not need to file for the year the business was incorporated.

Consequences of not filing an annual return

Corporations Canada has the power to dissolve a corporation that has not filed its annual returns. Dissolution can have serious consequences, including not having the legal capacity to conduct business. This includes raising capital or accessing credit and loans.

While the law allows Corporations Canada to dissolve a corporation after one year of non-filing, the policy is to only dissolve a corporation when it has not filed an annual return for two years.

Minute Books

What are minute books?

Minute books are detailed records that document an incorporated company's structure and activities. They must be updated every year as part of the incorporation's annual return to maintain its legal structure and include:

- Articles of Incorporation
- Articles of amendment
- By-laws
- Resolutions and minutes
- Share certificates and share transfer registers
- Directors, Officers and Shareholder Registers
- Notices that have been filed
  - Change of registered office address
  - Changes regarding directors
- Shareholder agreements

They also track key company decisions such as granting of shares, dividends and management fees.

Why do they matter?

Minute books are required to maintain an incorporation. If a business does not have them or keep them up to date, they could be found in default of mandatory government notice filings (making them non-compliant); fined by the CRA as part of an audit; refused for loans by banks; and any potential future sale of their business or assets could be in jeopardy or face lengthy and expensive legal delays.

Does FBC maintain minute books and file Annual Returns?

FBC provides an affordable option to better maintain the corporate records of those businesses who use FBC for tax filing. We take care of updating minute books and filing the Annual Return each year when preparing and filing taxes.

FOUR STEPS TO INCORPORATING YOUR BUSINESS

Incorporating a business can be done federally or provincially.

If you're going to stick to operating your business in one province, it makes sense to incorporate on the provincial level. If you want to operate in more than one province in the future, you'll need to get a license for every province you want to operate in. If you want to operate across the country, it's wise to consider federal incorporation.

In general, there are four basic steps:

Step 1: Name your corporation

Because you're creating a legal entity, your corporation must have either a word name or a number name. Here's a quick breakdown:

- Word name, made up of letters and symbols – for example, William Widget Manufacturing Inc.; or
- Numbered name – for example, 12345678 Ontario Ltd.
- Using the NUANS or "Federal Corporations Search" service, you must ensure that there is no other corporation with an identical or similar name to the one you are proposing. Identically named corporations are not allowed
- If you choose a numbered company name, you can still use an "operating as" name to market your business
- Corps require a legal element such as "Ltd.", "Inc.", or "Corp."
- Professional corps are limited to use by regulated professional services such as lawyers, chartered accountants and health professionals

Step 2: Create your articles of incorporation

If you are incorporating provincially or federally, you must use their forms to submit your articles of incorporation. Generally, they include:

- Name of corporation
- Contact information
- Classes of shares and information on share structure or transfers
- Number of directors your incorporated business will have (min & max)
- Restrictions on business or business activities
- Other rules or provisions (pre-emptive rights, voting provisions)

Step 3: Confirm the initial registered office address and first board of directors

Every incorporated business must have the following:

1 A registered office address:

Your corporate registered office is where you must keep your records. It is also where official documents are served so you should choose an address where you are sure to receive them. Legally, official documents sent to this address are assumed to have been received by the corporation.

If your initial registered office changes, the new address needs to be reflected in your minute books.

2 A board of directors:

You also need to decide who will be on your incorporated business's board of directors. There are some required eligibility criteria so make sure they qualify before registering them as such.

Generally, a director must:

- be at least 18 years old
- not have been declared incapable under the laws of a Canadian province or territory, or by a court in a jurisdiction outside Canada
- be an individual (a corporation cannot be a director)
- not be in bankrupt status

You must also disclose each director's first name, last name, address, and indicate whether they are a resident Canadian. Typically, at least 25 per cent of the directors of a corporation must be resident Canadians. If a corporation has fewer than four directors, however, at least one of them must be a resident Canadian.

Step 4: Submit application and pay fees

When you submit your application, it must go to the regulating office of the jurisdiction in which you're incorporating your business (federal or provincial). There are also required fees.

The fees vary based on where you're incorporating and the method you choose to submit your registration (online, mail, through a registry service, etc.)

UNDERSTANDING CORPORATE TAX FILING REQUIREMENTS

Tax deadlines for incorporated businesses

T2 - Corporate Tax Return

You are required to file no later than 6 months after your fiscal year-end. If your fiscal year-end is December 31st, your T2 return will be due June 30th the following year. When the T2 filing deadline falls on a Saturday, Sunday, or a public holiday, the return is due on the first business day following the filing deadline.

You have the option to change your fiscal year-end but must apply for approval from CRA.

T4 – Statement of Remuneration Paid

Employers are required to file a T4 information return (T4 Summary and T4 Slips) to report remuneration paid to their employees. You must give employees their T4 slips on or before the last day of February following the calendar year to which the slips apply. If this date falls on a Saturday or Sunday, the due date is the next business day.

T5 – Return of Investment Income

The T5 return (T5 Summary and T5 Slips) reports various types of investment income (e.g. dividends and interest) paid to residents of Canada, including corporations. You have to file your T5 information return by the last day of February following the calendar year to which the information return applies. If this date falls on a Saturday or Sunday, the due date is the next business day.

Payment Deadlines

If your business has a balance that it needs to pay, you have until 2 months after the end of your tax year to pay it off (2 months after your fiscal year-end). There are some exceptions to this rule. Canadian-controlled private corporations with annual business income less than $500,000 may have up to 3 months rather than 2 if they meet the eligibility criteria.

Generally, corporations have to pay their taxes in instalments, either monthly or quarterly.

Instalment payments are due on the last day of every complete month of your tax year, or of every complete quarter if you are an eligible small CCPC.

There are exceptions to the instalment payment rule, speak to a tax specialist for more information.

Late Filing Penalties

If you owe money on your corporate tax return and it's late, the CRA charges a late-filing penalty.

The penalty is 5% of your balance owing + 1% of your balance owing for each full month your return is late, to a maximum of 12 months. You will also be charged daily interest on any outstanding tax owing.

Your corporation will be charged an even larger penalty if it was issued a "demand to file" from the CRA and was assessed a failure to file penalty in any of the three previous tax years.

The penalty is 10% of the unpaid tax when the return was due, plus 2% of this unpaid tax for each complete month that the return is late, up to a maximum of 20 months.

Stay on top of your tax deadlines and you won't have to worry about interest and penalties.

Instalment and Other Penalties

The CRA may charge your corporation penalties for other reasons including:

- late or incomplete instalment payments
- failure to provide information on an authorized or prescribed form
- when instalment interest is more than $1,000
- if a corporation makes a false statement or omission on their return
- not complying with mandatory internet filing (applicable to corporations with annual gross revenue exceeding $1 million)
- failing to distribute T4 slips to recipients

PAYING YOURSELF FROM YOUR CORPORATION

There are 3 ways to take money out of a corporation:

1. By paying yourself a salary
2. Through dividends (payments declared by the directors of the company and paid to the shareholders of the company)
3. Through a shareholder loan (must be repaid—speak to a tax specialist for more details)

As a business owner with a corporate structure, you can pay yourself a salary, dividends, or do a mix of both.

The method you use to pay yourself personally from your corporation has an impact on many different things—and not just your personal income tax owing. While dividends likely create the lowest personal tax liability, they don't allow you to create contribution room to RRSP, build up CPP, take advantage of childcare credits and they may create issues with potential WCB claims. The form of your personal compensation can affect what you receive from government programs and credits as well as your ability to qualify for loans from lending institutions.

Let's look at the differences below, and what each option could mean for you when deciding how to structure your compensation.

Paying Yourself a Salary

If you decide to pay yourself a salary, you'll need to register a payroll account with the CRA. Each time you pay yourself, you'll need to withhold and remit income taxes to the CRA.

You're also required to make mandatory payments to the CPP on your income. If you're a small business owner and your net income is more than $3,500, you will end up paying double the CPP than you would as an employee, as you are paying both the half of the employer and the half of the employee; however, keep in mind that both portions are tax deductible.

Paying yourself a salary would be a good option if you are relying on CPP as part of your retirement savings. Your RRSP contribution room is also built using your business salary. As well, if you incur child-care costs in the year, the lower-income earning spouse can deduct those costs from employment income. If both spouses were to receive only dividend income, those costs would not result in any tax savings and therefore "lost".

Paying Yourself Dividends

Dividends can be paid to shareholders of your corporation. Dividends are considered investment income instead of business income. You might pay slightly less personal tax on dividends than on a salary, since you receive a dividend tax credit.

When you want to prepare dividends for your shareholders, you move the cash from your corporate account to the shareholder's personal account. You'll have to prepare and file T5s to the CRA for anyone who receives dividends.

You won't need to register for payroll and remit source deductions if there are no payroll (salary) payments.

Paying yourself dividends could be right for you if you don't want forced CPP contributions. Keep in mind dividends also do not build RRSP contribution room, so you'll want to have your own retirement plan in place.

Taking Out a Shareholder Loan

Although shareholder loans are not considered to be a method for paying yourself, they are a way to take money out of your corporation.

Shareholders may use corporate funds for personal uses throughout the year. These amounts are considered loans from the corporation to the shareholder.

As long as the money is repaid before the end of the corporation's fiscal year-end, you do not have to pay personal tax on the borrowed funds.

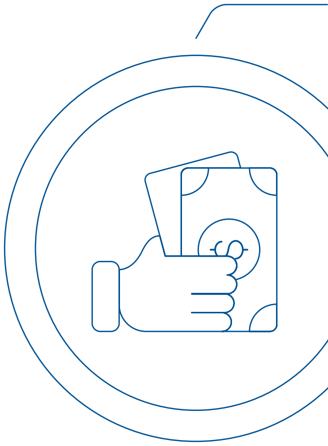
Shareholder loans can be enticing for business owners, but they may not be right for your individual situation (learn more about shareholder loans on page 25).

So How Should I Pay Myself as a Business Owner?

It depends on your individual business and family situation. Dividends are a more flexible payment option and you don't have to pay into CPP so you'll reduce your costs that way. However, you'll need to be careful about contributing to your own retirement savings, and keep in mind that you won't be creating contribution room in your RRSP by issuing yourself dividends.

Also, dividends aren't typically accepted as salary on loan applications if you're applying for a mortgage or other lines of non-business credit.

There are many other factors, such as other income sources, that can impact whether you should be paying yourself a salary or dividends. Speak to a tax specialist to find out which option is right for you.



WHAT IS A SHAREHOLDER LOAN?

Have you heard of a shareholder loan and wondered what it is and how it works? Keep reading and learn more about it here.

As Canadian interest rates continue to soar, the idea of taking out a loan from your corporation at no or low interest may be increasingly appealing.

But, before you start using a shareholder loan account, it's important that you understand the associated tax implications. While shareholder loans may initially look attractive to many small business owners, they may not be a good fit for your individual situation.

If you're considering taking out a shareholder loan, here is what you need to know before you make that decision.

What Are Shareholder Loans?

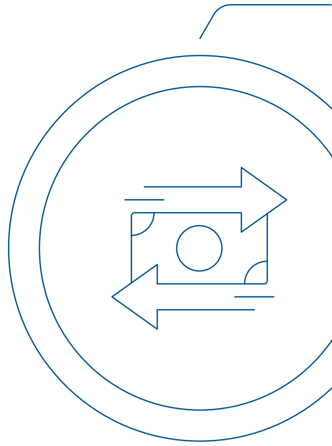
A shareholder loan is an amount that you, as a shareholder owe, to your corporation.

Typically, a shareholder is paid from the corporation through either salary or dividends. Dividends are paid from after-tax corporate profits and taxed at a personal level. Salary payments require source deductions to be paid in a timely manner (i.e. CPP and income tax must be remitted to CRA usually by the 15th of the following month). Shareholders may use corporate funds for personal uses throughout the year, outside of the traditional salary or formal dividend arrangements. These amounts are considered loans from the corporation to the shareholder. This money has not been taxed at a personal level, so must either be repaid by the shareholder within a certain time frame (i.e. typically a year), or must be included in the shareholder's personal income.

A shareholder loan can be made to your own company, a company related to your company, or a partnership of which your company is a member. The company can give shareholder loans to any shareholder of the company and any person connected with the shareholder of the company. Check out the Canada Revenue Agency website on who are connected shareholders.

How Can You Use Shareholder Loans?

There are four common uses for shareholder loans: two that are considered "due from shareholder" loans and two that are considered "due to shareholder" loans.



Due from Shareholder

If you withdraw money from your incorporated business and it is not designated as salary or dividends paid to you, it is considered a loan from the company to you, the shareholder.

Another common "due from shareholder" loan takes place when company money is used to purchase a personal item.

In both situations, corporate funds have been borrowed for personal purposes and personal tax has not been paid on those amounts. Be aware that these types of loans are subject to special rules such as requiring repayment to the corporation within a year.

Due to Shareholder

If you pay for company expenses using personal funds or loan money to the company, this is considered an owner contribution and is reflected on the balance sheet as a debt owed (liability) by the company; the company will need to pay the owner back at some point.

What Are the Tax Implications of Shareholder Loans?

Before taking out a shareholder loan, there are several tax implications you need to be aware of. The most important is the shareholder loan repayment rule. The basic rule is that the amount of the shareholder loan will not be included in your taxable income if you repay the loan within one year from the end of the fiscal year of the corporation.

For example, assume you own shares in Company A, and Company A has a fiscal year-end of December 31. If you borrowed money from Company A on December 1, 2021, you need to repay the loan by December 31, 2022.

Tax Income Impact of Shareholder Loans

If you don't repay the money within that time, you must include the unpaid amount in your taxable income and pay income tax on it.

Also, if you didn't charge an interest rate on the loan, you must also add interest rates equal to the prescribed rate to your taxable income. The prescribed rate is currently 2% but is subject to revision every quarter. This interest is considered a taxable benefit to you, as a shareholder, and it reflects a benefit you received (i.e. a loan) due to your role as a shareholder. Taxable benefits are included in your personal taxable income.

Exceptions to the Shareholder Loan Rules

You can take out a shareholder loan for a longer period in certain circumstances. For example, if your company's business is to give out loans, and the shareholder loan is made in the ordinary course of the business, then as long as the terms of your shareholder loan are similar to that of any unrelated borrower, you don't need to repay the amount within one year and you won't run into any tax issues.

You can also take out a shareholder loan if you purchase a motor vehicle for company use or if you purchase a principal residence for the shareholder, this can include a house, condo, cottage, or mobile home. There are certain conditions which must be met in order for this to apply (i.e. must have a legitimate repayment plan with a reasonable time frame, etc.).

What to Know Before Taking Out a Shareholder Loan

Remember, your corporation is a separate entity from you; therefore, corporate funds and personal funds must be kept separately. You should also keep proper paperwork and structure your shareholder loans correctly to avoid any issues at tax time.

However, one of the best ways to safeguard yourself from potential problems with CRA is to speak with a tax specialist and make sure that the right paperwork is in place, such as clear tracking of the transactions made through the shareholder loan account, so it's clear to CRA that you will or have paid off the loan, and that you keep paper records of repayment.

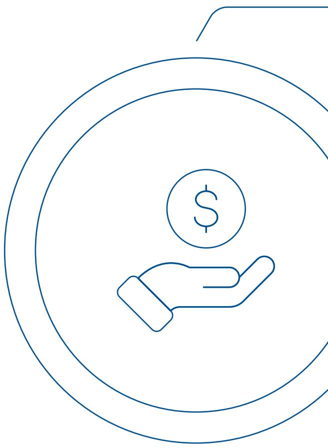
If the loan is to a related party, you should consider a separate and detailed loan agreement to protect your rights and the rights of the borrower.

DO YOU KNOW WHICH TAX DEDUCTIONS AND CREDITS APPLY TO YOU?

We've compiled a list of tax deductions and credits that may help lower your tax bill.

Federal Tax Credits

There are tax credits available at both the federal and provincial level but here we highlight some common federal tax credits for small businesses that you should be taking advantage of.



Investment Tax Credit – Property, Machinery, Equipment

Investment Tax Credits (ITC) allow you to claim tax credits if you invested in your small business, bought machinery, equipment or new buildings.

What if you could have taken advantage of investment tax credits, but forgot to? You can carry forward credits earned in tax years that end after 1997 for up to 20 years. You can also carry back the credit you earn for up to 3 years.

You may be able to claim a refund of your unused ITCs as well.

Since there are eligibility rules and requirements that must be met before claiming investment tax credits on property, machinery and equipment, it's recommended that you speak to a tax specialist to ensure you're following the rules.

Apprenticeship Job Creation Tax Credit

If you own a small business that has hired an apprentice, you can claim 10% of their wages, up to a maximum of $2,000 per eligible employee.

An eligible apprentice is someone who works for you in a qualifying trade in the first two years of their field of expertise.

Any unused credit can be carried back 3 years and carried forward 20 years (to help offset larger tax bills).

Scientific Research and Experimental Development (SR&ED) Tax Credit

This program encourages Canadian businesses to conduct research and development by providing cash refunds and/or tax credits for your research and development expenditures.

You can pool your SR&ED expenditures and deduct them against your current year income or keep them and deduct them in a future year.

You can also earn the SR&ED investment Tax Credit and use it to reduce your income tax payable. In some cases, the CRA will refund the remaining ITC.

If your SR&ED work is eligible, your investment tax credit will be at least 15% and can be as much as 35% of qualified SR&ED expenditures. If you have any unused ITCs, you can carry them back three years or forward 20 years and apply them against tax payable for other years.

The provincial governments and territories also support SR&ED through additional tax credits and grants.

Input Tax Credit

You may be able to recover GST/HST paid or payable on purchases and expenses related to your business, by claiming input tax credits but you must have a registered GST/HST number to claim them.

Keep track of GST/HST paid on eligible business expenses so that you can claim them on your GST/HST return. Be sure to keep your receipts should you be required to back up your claims.

Charitable Donations

You can claim eligible charitable donations to a limit of 75% of your net income. The donation must be made within the corporation's fiscal year to be claimed, but you can carry forward unclaimed donations for up to five years.

WHAT EXPENSES ARE ELIGIBLE FOR INPUT TAX CREDITS?

To claim an input tax credit, the expense(s) must be reasonable in quality, nature, and cost in relation to the nature of your business. According to the CRA's website, the following expenses may be eligible for input tax credits:

- business start-up costs
- business-use-of-home expenses
- delivery and freight charges
- fuel costs
- legal, accounting, and other professional fees
- maintenance and repairs
- meals and entertainment (allowable part only)
- motor vehicle expenses
- office expenses
- rent
- telephone and utilities
- travel

The following expenses are NOT eligible for the input tax credit:

- certain capital property
- taxable supplies of property and services bought or imported to make exempt supplies of property and services
- membership fees or dues to any club whose main purpose is to provide recreation, dining, or sporting facilities (including fitness clubs, golf clubs, and hunting and fishing clubs), unless you acquire the memberships to resell in the course of your business
- property or services you bought or imported for your personal consumption, use, or enjoyment

Additional Corporate Tax Credits and Special Accounts

Refundable Dividend Tax on Hand (RDTOH)

A dividend refund may be available to private corporations that pay taxable dividends in a taxation year. The calculation of a private corporation's dividend refund is based on two accounts, the eligible refundable dividend tax on hand (ERDTOH) and the non-eligible refundable dividend tax on hand (NERDTOH).

Capital Dividend Account (CDA)

With a positive balance in this account, you may be able to pay out tax-free income to shareholders.

General Rate Income Pool (GRIP)

If your Canadian-controlled private corporation makes over $500,000 a year in active income and/or generates investment income, you may be able to use Eligible Dividends to trigger a partial tax refund to your corporation and claim a higher dividend tax credit personally.

Speak to a tax specialist for more information on how to utilize the RDTOH, CDA or GRIP for your corporation.

What is the difference between a tax deduction and a tax credit?

Tax deductions are allowable expenses that reduce your taxable income whereas a tax credit is a percentage of an expense that directly reduces the amount of tax you must pay to the CRA.

Small business tax deductions (or "write-offs") include business expenses such as rent, office supplies, advertising, and promotion. The total impact of the tax deduction on your taxable income depends on your tax rate.

A tax deduction must also be claimed against the income earned in the year the expense was incurred.

Once you've applied your tax deductions to your taxable income and calculate your tax owing, you can then apply your eligible tax credits. Tax credits (typically 15 per cent of the total expense) reduce this tax amount owing on a dollar-for-dollar basis. If you spend $500 on a cost eligible for a tax credit, you may receive a tax credit of 15 per cent for a total of $75 saved on your tax owing.

Claiming tax deductions and credits can be complicated so you should work with a specialist to ensure you're applying them correctly.

Tax Deductions

Advertising

You can deduct expenses for online advertising, advertising on Canadian radio and television stations and Canadian newspapers and magazines, as well as promotional materials like business cards and pamphlets.

Sponsorship of local sports teams, and other branded charitable donations, can be claimed as advertising if the materials include your branding and logo, which could potentially increase awareness of your business.

Bad Debts

If you are owed money from a client but are unable to collect it within a year, you may be able to claim it. You can generally deduct an amount for a bad debt if:

- you had determined that an account receivable is a bad debt in the year
- you had already included the receivable in income

Note: Recovery of bad debts previously written off must be included in income in the year it was recovered.

Business Taxes, Licenses and Memberships

You can deduct annual licence fees (beverage, trade, motor vehicle licenses) and some business taxes (municipal taxes, land transfer taxes, gross receipt tax, health and education tax, and hospital tax).

You can also deduct annual dues or fees for trade or commercial associations, as well as magazine subscriptions if they're expenses incurred to earn business income.

Note: You cannot deduct club membership dues (including initiation fees) if the main purpose of the club is dining, recreation, or sporting activities such as golf club memberships.

Delivery, Freight and Express

You can deduct the cost of delivery, freight, and express incurred in the year that relates to your business.

Fuel Costs (Except for Motor Vehicles)

You can deduct the cost of fuel (including gasoline, diesel, and propane), motor oil, and lubricants used in your business.

Fuel for motor vehicles will be deducted under motor vehicle expenses/ business use of your personal car.

Interest and Bank Charges

You can deduct interest on money that was borrowed for business purposes or for buying property for your business. You can't deduct the principal of loan or mortgage payments, or any money borrowed for personal purposes.

You can deduct the fee you pay to reduce the interest rate on your loan, along with any penalty a bank charges you to pay off your loan before it is due.

You may be able to deduct certain fees you incur when you get a loan to buy or improve your business property. These fees include:

- application, appraisal, processing, and insurance fees
- loan guarantee fees
- loan brokerage and finder's fees
- legal fees related to financing

Typically, costs associated with financing are deducted over a period of five years, regardless of the term of your loan. Talk to a tax specialist for more information.

Insurance Premiums

You can deduct insurance premiums you pay for insurance on buildings, machinery, and equipment you use for your business.

Legal and Accounting Fees

In some cases, fees for accounting, bookkeeping, tax preparation and finances can be deducted, along with legal fees.

Meals and Entertainment

You can deduct 50 per cent of your total meal and entertainment expenses for business purposes.

Capital Cost Allowance

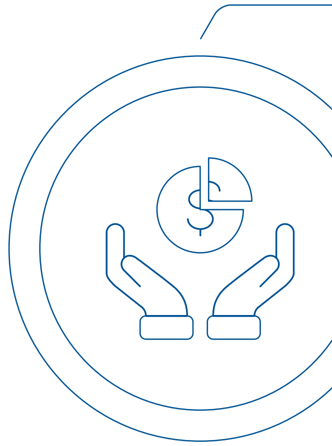
If you acquire depreciable property or asset for your business, such as a building, furniture, or equipment, its cost may be deductible over numerous years. This is to reflect that the use of the asset or property spans more than one year. This yearly deduction is called a capital cost allowance (CCA). There are a few rules you need to follow to claim it.

- You cannot deduct its full cost when you calculate your net business income for the year in which you acquired the asset or property. It must be deducted over a period of years.
- Typically, office furniture and tools are considered Class 8 property that allows you to deduct 20% for your annual CCA
- Computers and other data processing equipment is Class 10 which allows for 30% CCA
- There are different rules and classes depending on the asset, its use and its value. We recommend talking to a tax specialist to determine the optimal application for this deduction.

The government introduced the Accelerated Investment Incentive measure to increase the first year deduction of certain assets.

Office Expenses

This includes small items like pens, pencils, paper clips and stationery. You can't claim items valued at over $500 such as furniture or computer equipment, which would qualify as capital items.



Rent

You can deduct rent incurred for property used in your business.

Repairs and Maintenance

You can deduct the cost of labour and materials for any minor repairs or maintenance done to property you use to earn income.

Salaries, Wages and Benefits

You can deduct employees' gross salaries and other benefits incurred by you as the employer. As the employer, you must deduct your part of CPP contributions and employment insurance premiums. You can also deduct workers' compensation amounts payable on employees' remuneration.

If you pay yourself a salary out of your corporation (instead of dividends), your wages and benefits would be included in this calculation.

Travel Expenses

You can deduct travel expenses, including transportation fares and hotel accommodation.

Business Use of your Personal Car

If your company uses any personal assets, you have a right to be reimbursed or compensated for this. An example is if you use a personal car for business purposes.

You would pay all vehicle expenses personally and the corporation could provide you with a tax-free allowance for business travel. You would need to keep a mileage log to track the kilometers the vehicle traveled for business purposes.

The company would then pay you personally based upon rates provided by the Canada Revenue Agency (61 cents per kilometer for the first 5,000 kilometers and 55 cents per kilometer over that).

Net Operating Losses

Net operating losses generally may be carried back three tax years and forward 20. There are special rules and exceptions that apply, speaking with a tax specialist is recommended.

Fines and Penalties

Fines and penalties that are not government-imposed are generally deductible if incurred for the purpose of gaining or producing income from the business or property.

Claiming non-capital losses

You have to be careful with what you claim, and where.

For example: If your business is incorporated, any non-capital losses can't be used to reduce income on your T1—your personal tax return. But non-capital losses can be applied against income on your T2 to reduce the corporation's tax bill. Non- capital losses can also be carried back or carried forward to recover tax you've paid in the past or help reduce a tax bill in the future.

Talk to a tax specialist to find out when it's strategic to report non-capital losses.

ARE YOUR RECORDS IN ORDER?

You are required by law to keep records of all your transactions to be able to support your income and expense claims. You must keep daily records of your income and expenses, along with vouchers and receipts.

If you don't maintain records and are audited by the CRA, you could face hefty fines and penalties.

Because your records may be inspected by tax auditors, they should be properly stored along with cancelled cheques and other vouchers to support your book entries.

Good record keeping is essential to any business, since it provides you with accurate, up-to-date information on the financial position of your business, helps you with business planning and satisfy creditors if you want a loan.

Keep your records for at least six years after your last Notice of Assessment, which is typically as far back as the CRA will ask to see them in the event of an audit. You can keep the physical receipts or digital copies.

Make sure the income you report is supported with original documents, which include sales invoices, bank deposit slips, fee statements, contracts and receipts.

The CRA won't accept your bank or credit card statements to justify deductible business expenses—you need an itemized receipt that corresponds with the transaction.

The receipts must show the date of the purchase, name and address of the seller or supplier, your name and address, the full description of the goods or services and the seller's business number if they register for GST/HST. If you don't have receipts, the CRA could disallow your expense claims.

HAVE YOU HIRED A TAX SPECIALIST?

A tax specialist keeps your books and records in order, tracks your progress and compares past and present financial positions, plans and forecasts future financial positions and provides information to make sound business decisions.

They keep on top of filing deadlines, so you avoid penalties and interest, and stay up-to-date with tax rules and regulations so you receive all the credits you're entitled to.

They give you an overview of your financial situation and provide long-term tax planning that reduces your yearly tax bill.

If you are audited by the CRA, a tax specialist can represent you so that you don't have to take time away from your business to deal with the audit process.

Tax Preparation Checklist for Incorporated Businesses

The following two pages are a summary of the documents you need to file your tax return along with a list of business deductions you can use to lower your tax bill. Bring the documents below to your FBC tax specialist so they can create a tax plan customized to your business and personal situation.

BUSINESS RECORDS

- [ ] **Deposit slips**
- [ ] **Bank statements**
- [ ] **Income records**
  - [ ] Sales invoices
  - [ ] Receipts
  - [ ] Bank deposit slips
  - [ ] Fee statements
  - [ ] Contracts
- [ ] **If you have employees**
  - [ ] T4: Summary of Remuneration Paid
  - [ ] T4A: Summary of pension, retirement, annuity and other income
- [ ] **If you make payments to subcontractors**
  - [ ] T5018: Statement of Contract Payments
- [ ] **Shareholder transactions and dividends**
- [ ] **Receipts on any capital purchases or sales**
- [ ] **Worker's compensation payments or benefits**
- [ ] **Instalments made for income tax, GST/HST/PST and payroll**
- [ ] **Payroll, source deductions and taxable benefits for employees**
- [ ] **Previous tax year slips and receipts**
  - [ ] T1 Personal tax return, Notice of Assessment and any other CRA correspondence
  - [ ] T2 Return, Notice of Assessment and any other CRA correspondence
- [ ] **Investment information**
  - [ ] T3 slips
  - [ ] T5 slips
- [ ] **Minute Book for updating and filing**
- [ ] **Annual Return for updating and filing**

BUSINESS DEDUCTIONS

- [ ] Advertising
- [ ] Bad debts
- [ ] Business taxes, licenses and memberships
- [ ] Charitable Donations
- [ ] Delivery, Freight and Express costs
- [ ] Fines and Penalties
- [ ] Fuel Costs
- [ ] Interest and bank charges
- [ ] Insurance premiums
- [ ] Legal and accounting fees
- [ ] Meals and entertainment
- [ ] Capital Cost Allowance
- [ ] Office expenses
- [ ] Office stationary and supplies
- [ ] Rent for property used in your business
- [ ] Property taxes if not included in base rent on property used for business
- [ ] Repairs and maintenance
- [ ] Salaries, wages and benefits incurred by you as an employer
- [ ] Travel expenses
- [ ] Mileage logbook and deductions for personal use of car

To find out more about how we can support your business, take 15 minutes to connect with us so we can get to know each other.

Click here to book a consultation

Call us at **1-800-265-1002**

For more free tax and business resources, please visit **www.fbc.ca**
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