

## **Proprietorships, Partnerships, and Small Corporations Getting Organized - The Basics**

### **What your Accountant (and Canada Revenue Agency) would like to see.**

Keeping track of your day to day business operations can be a daunting task for most people. When you are starting a new business it is stressful enough without the added issue of dealing with the paperwork.

The following tips will provide you with basic steps to enable you to organize your information in a manner that is useful for your accountant as well as providing the detail required by CRA.

**To get started you will need a box of file folders or a box of 8 ½ x 11 envelopes.**

### **Revenues**

Ideally, each year you should provide your accountant with a summary of your annual sales.

- 1) Depending on the volume of the “sales”, you can batch your sales on a daily, weekly, or monthly basis, and if the volume is very light, you can total your invoices on an annual basis.
- 2) Using an adding machine, run individual tapes on your net sales, any taxes collected (if applicable) making sure that HST/GST and Provincial Tax are added on separate tapes, and then finally a tape on your gross sales.

**Tip:** As a quick check for accuracy, net sales + taxes = gross sales.

- 3) Each totaled batch of sales invoices should be placed into an envelope or folder. The totals of the batch should be written on the outside of the folder. You continue with this process for the entire year.

When you are ready to bring your information in to your accountant, you just add up all of your batches and place the totals on a summary sheet. Be sure to run a quick check for accuracy on your grand totals.

### **Expenses**

**For any expense to be deductible for tax purposes you need to be able to establish that it was incurred for the purposes of earning income, was not personal in nature, and is a reasonable amount.**

You will need to prepare a folder or envelope for each applicable category.

- 1) Depending on the volume of the expense, you can batch your expense on a daily, weekly, or monthly basis, and if the volume is very light, you can total your expense on an annual basis.

**Tip:** CRA does NOT accept bank statements, credit card statements, or credit card receipts as proof of payment. In the event of a CRA audit, CRA will disallow an expense claimed that is not backed up with its original invoice. **KEEP ALL ORIGINAL INVOICES FOR 7 YEARS.**

- 2) Using an adding machine, run a tape on the total amount paid for an expense. If your business is registered for GST/HST you will need to run a separate tape on the HST/GST paid. To summarize your expenses if you are registered for HST/GST you will need to calculate the total net expense. Net expense is calculated by taking your total expense and subtracting the total GST/HST paid.
- 3) Each totaled batch of expenses should be placed into an envelope or folder. The totals of the batch should be written on the outside of the folder. You continue with this process for the entire year.

When you are ready to bring your information in to your accountant, you just add up all of your batches and place the totals on a summary sheet. Be sure to check your accuracy on your grand totals.

### **Cost of goods sold**

This section is for businesses that have products for sale. If this section does not apply to your business, skip to the following section.

To determine the cost of goods sold you will need to provide the following information:

- Opening inventory amount (if you are just starting out, this amount will be zero)
- The cost for product purchases made during the year
- Wages paid for employees during the year (if applicable)
- Amounts paid to subcontractors during the year (if applicable)
- Closing Inventory amount

To determine your cost of goods sold you will have to do an ending inventory count. Make a list of all the items you have on hand for resale at the end of your fiscal period. You will have to determine a cost value for your closing inventory. There are a number of different ways to determine inventory costs. You can choose to use actual costs or average costs to value your inventory. You may need some advice from your accountant at this point.

If you work on a markup basis and only know the retail value of the inventory then write down the retail value on your inventory sheet as well as the markup that relates to the item. To get the cost value, you will divide the retail amount by the markup. (For example, a \$100 retail item with a 15% markup, the cost calculation would be  $\$100/1.15 = \$86.96$ . To test this calculation  $\$86.96 \times 15\% = \$100$ .)

**Tip:** In the event of an audit CRA **WILL** request to see an actual inventory count.

**The following is a list of the most common expenses associated with small businesses:**

Advertising	Meals and entertainment
Bad debts	Insurance
Interest	Office expenses
Business tax, fees, licences, dues, memberships, and subscriptions	
Supplies	Legal, accounting, and other professional fees
Management and administration fees	Rent
Maintenance and repairs	Salaries, wages, and benefits
Property taxes	Travel
Telephone and utilities	Fuel costs (not motor vehicle fuel)
Delivery, freight, and express	Purchases
Motor vehicle expenses	Business Use of Home
<i>Fuel and oil</i>	<i>Heat</i>
<i>Interest</i>	<i>Electricity</i>
<i>Insurance</i>	<i>Insurance</i>
<i>Licence and Registration</i>	<i>Maintenance</i>
<i>Maintenance and repairs</i>	<i>Mortgage Interest</i>
<i>Leasing</i>	<i>Property taxes</i>
<i>Parking</i>	<i>Water, sewer, garbage</i>
<i>Supplementary business insurance</i>	

### **Advertising and promotion**

Items that may be considered advertising costs are the costs related to newspaper, television, and radio advertisements, telephone book yellow pages, the printing of business cards, and information pamphlets. The costs regarding a fundraising or a charitable event would also be recorded in this section.

**Tip:** If a donation of product has been made to a registered charity, to be able to claim the donation a corresponding amount must be **added to your revenues**.

**Tip:** Receipts for gifts or promotions should be identified. CRA requires that each receipt be documented with the following information:

- Purpose of the gift/promotion expense
- Recipient of the gift/attendees of promotion event

### **Meals and entertainment**

Eligible receipts will be for costs related to the entertainment of your clients and potential customers. Only 50% of meals are deductible, however there are certain exclusions to this rule – please discuss with your accountant.

**Tip:** CRA requires that each meal and entertainment receipt be documented with the following information:

- Purpose of the meeting
- Who attended the meeting
- The result of the meeting (i.e., became a client, placed an order)

Special rules apply for long haul truck drivers, bicycle couriers and rickshaw drivers. Due to the physical demands of these jobs, the claim for meals is increased to 80% of the total costs. The receipts for these costs should tie in to time sheet dates.

### **Bad debts**

NSF cheques received, and any sales invoice that is deemed to be uncollectible should be recorded here.

**Tip:** To claim an amount for a bad debt, the outstanding receivable amount must have been included in revenue.

### **Insurance**

Amounts paid for business liability insurance would be claimed here. ICBC and house insurance will be addressed in the Motor vehicle expense and Business use of home sections.

### **Interest**

Bank charges and fees as well as interest paid on a business line of credit are examples of costs that would be recorded as an interest expense. Interest paid for a vehicle loan will be claimed in the Motor vehicle expense section. Mortgage interest will be claimed in the Business use of home section.

**Tip:** If personal funds are used to finance your business there must be a clearly defined link to the business portion of the financing. All-in-one bank accounts and personal lines of credit are types of financing that the interest portion claimed may be challenged by CRA because there are no definite repayment requirements and usually contain a personal portion. We suggest having a separate business line of credit to avoid confusion.

### **Business tax, fees, licences, dues, memberships, and subscriptions**

Costs for business licences, dues and memberships paid to business related organizations, and subscriptions to magazines that are business related or used in a waiting room are types of costs that would be recorded in this category. Golf course, health club, and sports club memberships are not eligible expenses.

### **Office expenses**

Consumable office supplies consist of items like pens, paper, paper clips, file folders, and stamps. Larger office items like computers, printers, desks, chairs, etc should be entered as “Capital Cost Allowance” items.

### **Supplies**

Some businesses require the purchase of consumable supplies. Catalogues for distribution, product purchased for the use as samples, bags and boxes for customers, disposable paper for examination tables, lotions and oils for massage therapy are examples of consumable supplies.

### **Legal, accounting, and professional fees**

Legal, accounting, or fees paid to other professionals for the development of your business would be claimed here.

### **Rent**

Costs related to business occupancy of a commercial space. Costs relating to the business use of your residence will be covered in the Business use of home category.

### **Maintenance and repairs**

Costs related to repairs done on property and equipment you use to earn income (not including home office space repairs). Significant renovations to rented space will be classified as leasehold improvements and amortized over time (usually a five year period)

### **Salaries, wages and benefits**

Amounts paid to employees and can include amounts paid to your spouse or child. If you operate your business as a proprietorship or partnership your own labour is not an allowable expense. If you pay your spouse or child it must be for work that is necessary, that you would have hired someone else to do, and the payment of wages must be reasonable for the type of job performed and comparable to an amount you would have paid to a non-family member to perform the same work.

**Tip:** If you plan to pay wages and salaries, a payroll account should be set up and T4's should be issued to each employee.

**Tip:** If you claim a wage expense for your spouse or child, you must make sure that you have issued cheques as proof of payment for the wage expense claimed.

### **Travel**

Costs for travel include accommodation costs and transportation costs (i.e. air, ferry, etc).

**Tip:** CRA requires the following information with regard to travel costs:

- Purpose of the trip
- Number of people travelling
- Personal portion of the trip (costs relating to spouse or children should be deducted from expense). If you travel for a two-day convention to a destination like Hawaii but

decide to make a vacation out of the trip and extend your stay to two weeks. Then the non-convention days would be considered to be personal, so costs for meals, accommodations for that time frame should not be claimed.

- Result of the trip

### **Telephone and utilities**

Costs for telephone usage, including cell phone, internet usage, and utility costs pertaining to your office. (Utilities paid for home office will be included in Business Use of Home)

**Tip:** Monthly costs for your home telephone are not allowable. However, the long distance calls made for business purposes on your home phone are allowable.

**Tip:** With the extensive use of cell phones and internet as a replacement for land line communications, CRA is requesting proof of the business use of cell phones and internet.

### **Fuel costs**

These costs relate primarily to trucking, courier, taxi, or businesses using machinery. Fuel costs may include the cost for gas, diesel, propane, motor oil, and lubricants used in business. Automotive fuel costs will be claimed in the Automotive expense section.

### **Delivery, freight, and express**

Costs relating to the receipt and shipment of products, equipment and supplies.

### **Motor vehicle expenses**

These are costs relating to the business use of your vehicle which is determined by recording the actual kilometers you drove during the year for business purposes.

A separate file folder may be used for the following items using the batch system described in the Expenses section.

#### **Fuel and oil**

**Maintenance and repairs** - repairs like tire purchases and installation, tune-ups, regular maintenance costs. Costs for significant repairs like an engine rebuild may be added to the cost of the vehicle and amortized over time.

#### **Parking**

The following items are “one-of” expenses and may be kept in a single file folder titled ‘Motor vehicle expenses.’”

**Description and cost of vehicle** - a copy of your original purchase agreement or the current blue book cost of your vehicle is required by your accountant

**Interest** - complete details regarding the financing of your vehicle are needed by your accountant

#### **Insurance**

## **Licence and Registration**

**Leasing** - a copy of your lease agreement is required by your accountant

**Supplementary business insurance** - if your vehicle is licenced as a business vehicle, you may be charged an additional insurance fee so you will be covered while operating your vehicle for business purposes. This supplementary insurance is considered to be 100% business and will not be prorated like the other motor vehicle expenses.

**Tip:** In the event of an audit, CRA may disallow motor vehicle expenses not backed up by a mileage log. The easiest way to keep a mileage log is to have a calendar in your vehicle at all times. On January 1<sup>st</sup> of each year write down your odometer reading and on December 31<sup>st</sup> write down your odometer reading. Each time you make a trip for business, jot down the destination, purpose, and the mileage. At the end of the year total the mileage you drove for business purposes. Then subtract the December 31 odometer reading from the January 1<sup>st</sup> odometer reading to determine the total kilometers driven for the year. These two amounts will be the ratio used to determine your business use of your vehicle.

**Tip:** If you use multiple vehicles for your business activities, you should keep a separate log/calendar for each vehicle.

## **Business use of home**

These are costs relating to the business use of your home for a home office. You need to provide the total square footage of your home and the square footage of your office. If you use out buildings or your garage for storage then the square footage of each of these areas should be included in the total square footage as well as in the area of home used for business.

**Tip:** Allocating too much of your home as business use may have an adverse effect on your principal residence status, it may trigger a deemed sale, and may trigger GST/HST consequences on a future sale.

A separate file folder may be used for the following items using the batch system described in the Expenses section.

### **Heat**

### **Electricity**

**Maintenance and repairs** - these would be costs for repairs to your home, heating system, water tank, as well as costs to cut your lawn and weed your gardens. If you live in a condominium, the monthly maintenance fees would be claimed here.

### **Garbage**

The following items are “one-of” expenses and may be kept in a single file folder titled ‘Business use of home.’

**Insurance**

**Mortgage Interest**

**Property taxes**

**Water and sewer**

**Tip:** Business use of home expenses cannot increase or create a net business loss. Business use of home expenses can reduce the net income of a business to a zero balance. If all of the business use of home expenses cannot be utilized in the current year, these expenses will be carried forward to be utilized against future net income.