PELOROUS
WWW.THINKPELORUS.CA

301-3700 Steeles Ave W, Vaughan ON L4L 8K8
Tel. 905 850 3330 Fax. 905 850 3329

CLARITY VISION RESULTS

Business Matters
VOLUME 27 | ISSUE 4 | AUGUST 2013

TAXATION

Non-Taxable Employee Perks

Good employees are difficult to find, so it may be worthwhile to offer benefits that will encourage them to stay.

Many owner-managers would like to provide their employees with additional benefits but may be reluctant to do so because Canada Revenue Agency (CRA) requires that many benefits be included in employee compensation. Unfortunately, this may attract additional income tax for the employees and add costs to both the employee and employer for employment insurance and CPP.

Some benefits, however, are not taxable to the employee, yet may provide a deductible expense to the employer.

If you, the owner-manager, could design the ideal benefit for your employees, what features would it include? The following four factors may be worth considering:

1. a deductible expense to you;
2. no extra costs for you, such as employment insurance or CPP;
3. non-taxable in the hands of the employee; and
4. attractive enough to keep hard-to-replace employees working for you.

You may be surprised to discover that a few such benefits already exist — if they meet the right criteria.

Uniforms and Special Clothing

In most situations, an employer cannot provide clothing to an employee without creating a taxable benefit for the employee. Uniforms and special clothing (including protective clothing, safety footwear and safety glasses) are exceptions, however.

The Employee Point of View

When employees receive special work-use clothing and protective gear, the benefits to the employee are two-fold: employees don't have to spend their own money for these items and the CRA does not consider these items a taxable benefit.

The Employer Point of View

From the owner-manager's point of view, the benefits are also two-fold: a distinctive uniform, usually containing the employer's logo, is a walking advertisement for your business, while protective gear, if it helps to prevent injuries, keeps insurance costs down. The uniforms and protective gear are deductible expenses to the employer.

Reimbursement and Clothing Allowances

You can also provide employees with an allowance for uniforms, protective clothing, safety glasses, boots, etc., or reimburse them for purchases made with their own money. If the allowance is accountable (i.e., requires receipts) it is considered to be a reimbursement of expenses and is not a taxable benefit to the employee. If you do not require a receipt, the purchases must meet the following three criteria in order to be a non-taxable benefit to the employees:

1. laws require protective clothing on the worksite;
2. the employee purchases the protective clothing; and
3. the amount of the reimbursement is reasonable.

If laundry or dry cleaning costs are incurred to clean uniforms or protective clothing, employers may opt to pay a reasonable allowance to the employee or, alternatively, to reimburse the employee when receipts are presented. These costs are not taxable to the employee. (The reimbursement includes HST/GST recoverable by the employer.)

Cellular Phone Service

If you provide employees with a personal cellular or other handheld device for business use, the portion attributable to business is not taxable to the employee. In theory, if an employee uses any of these devices for personal use, the personal-use portion would be considered a taxable benefit. The CRA has, however, recognized that it is impractical to try to draw a distinct line between personal and business use. Instead, the CRA states:

> Generally, we do not consider your employee's personal use of the service to be a taxable benefit if all of the following apply:
>
> - The plan's cost is reasonable.
> - The plan is a basic plan with a fixed cost.
> - Your employee's personal use of the service does not result in charges that are more than the basic plan cost.

On-premises child-care facilities can be a non-taxable benefit.

Child-Care Expenses

Child care is not just a financial issue; it is also an emotional one. A non-taxable, child-care facility at work is an excellent way to keep employees happy. This benefit is only non-taxable to the employee if all the following conditions are met:

- child care must be provided at the place of business;
- services must be managed by the business;
- all employees must have the option of utilizing the service;
- the service must be provided free or with minimal costs attached;
- third parties (individuals who are not employees) cannot use the service.

Options to Consider

Assume for a moment you want to provide on-premises child-care facilities for your employees but the costs are so high you will have to offer the service to non-employees at a higher rate. If you decide to go that route, the difference between the cost to your employees (which may be as low as zero), and the price paid by third parties, will be considered a taxable benefit to your employees.

However, if you subsidize your employees to use the child-care services of a third party, the CRA considers the subsidy to be a taxable benefit to employees who use the service. If the subsidized care is for children 14 years of age or younger and for daily periods of less than 24 hours, you pay no HST/GST but you must contribute to CPP.

Internet

If you have employees working at home, you may wish to pay for the portion of their Internet service used for business. Internet costs for business use are a non-taxable benefit to the employee; however, the personal portion of Internet use must be included in the employee's income as a taxable benefit. It is up to the employer to determine the fair market value and the percentage of business use. The fair market value should be based on the employer`s cost, including GST/HST.

Spouses and Business Trips

Under most circumstances, any reimbursement for the cost of having a spouse or partner accompany an employee on a business trip is taxable to the employee. If, however, the spouse or partner is involved in activities related to the business and attendance is requested by the employer, reimbursement of reasonable travelling expenses is not taxable to the employee.

Education Cost for Employees' Children

Reimbursement of educational costs for employees' children is a taxable benefit to the employee. The CRA recognizes, however, that education facilities may not be available to employees' children because of the remoteness of the worksite or because the local curriculum is inadequate. If an allowance or reimbursement is paid and it is established that the following FOUR conditions are met, then the CRA may consider the amount to be a non-taxable benefit to the employee:

1. education is provided in one of Canada's official languages used by the employee;
2. the education facility must be the closest one available;
3. full-time attendance is required; and
4. the reimbursement must be reasonable.

GST/HST is not included as part of this benefit.

Parking

Taxable benefits regarding parking are a contentious issue for both the employer and the employee because many employees need to drive to work and believe the cost of parking should be absorbed by the employer.

Under most circumstances, parking is a taxable benefit to employees. The benefit to the employee is calculated at the rate charged for the parking plus HST/GST. Any contribution by the employee toward parking costs is deducted from the benefit. There are, of course, exceptions to the general rule:

- Employees with disabilities are not subject to the taxable benefit.
- If the employer provides parking because it is necessary to conduct business AND the employee must regularly use a vehicle (their own or a company vehicle), the add-on to income as a taxable benefit does not apply.
- Where your business operates from a mall or an industrial park and parking is considered free to all, a taxable benefit does not arise. The CRA recognizes that if an individual is not assigned a specific spot and therefore it is uncertain as to whether a parking spot is attainable, the benefit does not apply.

Be Prepared to Defend Yourself

In many of the situations discussed above, determination of the non-taxable portion of the benefit may be somewhat subjective. Owner-managers should be prepared to support their position with solid documentation in the event the CRA decides to challenge any claims.

TECHNOLOGY

Software for Better Asset Management

New software to manage amortization and depreciation gives you better control of your business.

Software developers have long recognized that bookkeeping and spreadsheet software do not cover the whole range of processes essential to effective management of a business. Software is now available that enables you to do complex calculations quickly that would otherwise require the time-consuming use of pre-calculated tables.

Amortization Software

Amortization software is designed to monitor your investments and borrowings. For example, you could input the principal amount of a mortgage loan, the interest rate, the payment periods and the term. Within seconds, you can see the dollar amount of the portion allocated to reduce the principal and the portion allocated to interest expense, as well as the new balance after the payment. By simply inputting a new principal payment amount, new payment periods and interest rate, you can explore as many "what if?" scenarios as you like.

Amortization software will probably prove of greatest value in budgeting and other types of financial planning because it enables you to create an infinite number of hypothetical situations. Here are a few examples.

1. These programs can show the impact of interest-bearing investment strategies by enabling you to determine the future value of an investment based on an assumed principal amount, interest rate and term. This is a valuable application for determining how much should be allocated to reach your goal, whether that goal is the purchase of an asset or the amount you will need for your own retirement.
2. Some software allows calculations for a variety of unknowns. For instance, if you know the loan principal, the term and interest rate, you can calculate the monthly payment amounts with the interest and principal broken out. You can also input different payment amounts or payment dates and calculate for simple interest, the Rule of 78, Canadian amortization, or use a 360-,364- or 365-day year.
3. You can determine the cost of a loan, the interest cost for a tax write-off, and work out the cash flow required to service the loan.
4. You can also use this software to check on the calculations of lenders, vendors, etc., who are trying to sell you something on credit. Not only can you check the interest rate and the term, but you can also quickly determine the actual interest rate built into the "interest free loans" that are proliferating in the marketplace these days. Companies that promote 84 months of interest-free financing are not carrying your loan for nothing! Further, if taxes, preparation and licences are all part of the cost of financing, this software enables you to calculate and compare the actual cost of purchasing the item over time.
5. Whether you are a borrower or investor, these amortization calculations will show the value of time and its relation to returns. For example, employees who make the financial decisions should be aware that lower monthly costs over a longer term can be more expensive than higher monthly costs over a shorter term.
6. As an owner-manager, you will be better prepared to negotiate repayment or investment schedules using fixed amounts with skipped payments or additional principal amounts.

7. If your business needs to buy new capital assets, this software will enable you to determine cash flow requirements, calculate write-offs for tax purposes, and manage the timing of new debt.

As with other types of software, amortization packages can range significantly in cost and features. At the entry level, freely downloadable Excel templates can handle simple, common scenarios. At the high end of about $150 per licence plus an annual renewal fee, the software is capable of handling complex scenarios and generating customisable schedules – similar to what your bank may provide when you get a mortgage.

Monthly amortizing expense shows up-to-date book values.

Asset Management Software

Owner-managers buy and sell capital assets on a regular basis, but are often hard pressed to remember where they are, when they were purchased or what they cost. Full-featured asset management software will enable you to keep track of all your capital assets. Here are some of the benefits such software can have for the management of your capital assets.

- Costs are recorded at the purchase date. When an asset is discarded, the date of disposal and the disposal value are recorded to ensure the asset does not accidentally stay in the accounting records.
- The appropriate amortization (depreciation) rate can be applied to conform to your company's accounting policy for the amortization of capital assets.
- Amortization expense can be calculated on a regular basis to create monthly journal entries that provide a more accurate determination of profit or loss.
- Monthly amortizing and recording allows you to view the book value of an asset at a moment's notice and know whether sale at disposal will result in a gain or loss.
- The manufacturer may offer insight into the useful life of an asset. After the rate and method of depreciation are set, the depreciation charges, which determine the future book value of each asset, can be established.
- Asset management software assists in managing insurance costs by ensuring that any assets disposed of are no longer insured, or that those substantially amortized are not overvalued for insurance purposes.
- Asset management software tracks the physical location of each asset and records the number of days on a particular job site or at a different warehouse. Such information may be useful for insurance purposes.
- Assets can be classified individually, by type (e.g., tractors, trucks, etc.) or account number for accounting purposes.
- For owner-managers with more than one business, asset management software removes the confusion as to which company owns what assets. This can be important for accounting purposes if one company leases assets to another.
- Some asset management software can be linked to your existing bookkeeping software. This allows entry of general ledger account numbers for the asset, accumulated amortization account and amortization expense that will create automated, recurring journal entries, which will save the time required for monthly entries or major adjustments at year-end. As well, this linkage provides a more accurate representation of the amortization cost and asset valuation.
- A link to Excel built into some asset management software permits the importing of data and eliminates the need for rekeying. At the end of a period, reports can be generated to show amortization for each asset or type, a summary of the general ledger postings, acquisitions and disposals and the book value of any or all assets.

The type of software you select will depend on the assets you want to manage. Fixed assets, such as physical property, fixtures, equipment and buildings tend to be more "permanent" and require continuous maintenance. IT assets include tracking hardware such as computers, plus the software licences loaded on them and in inventory (i.e., not in use). While computers are "physical" they have a relatively short useful life and are much more portable than the buildings in which they are used. You should choose software appropriate for the size and types of assets held by your business.

Better Business Management

Informative accounting requires more than an out-of-the-box bookkeeping system. The new softwares will enable you to track the location of your assets, more accurately calculate their values and determine the cost of financing. The result will be better budgeting and improved long-term planning.

MANAGEMENT

Quality Control in Business

The lessons W. Edwards Deming taught Japanese businesses in the 1950s can also be profitably applied in Canada today.

Quality control is not a new concept. In the Middle Ages, craftsman such as carpenters or masons formed associations called "guilds" to secure fair compensation for their work, and also to protect the "secrets of their trade". A craftsman learned the "best practices" of his trade as he moved from apprentice to journeyman and ultimately to master, who in turn passed on the quality standards to the next generation of apprentices and journeymen. It was the reliability of the masters' standards that established the consistency of the product and the loyalty of the customers.

Recognition of the Need for Quality Control

In our own century, the guilds are gone but quality control is essential to maintain clients, to meet provincial, federal and international standards or guidelines, as well as to honour the requirements of the various associations that govern the behaviour of workers within industries. For instance, The British Columbia Egg Marketing Board requires that "registered egg producers … follow the Recommended Code of Practice." This code evolved from the co-operation of the Canadian Federation of Humane Societies, the Canadian Food Inspection Agency, egg producers and egg processors who were resolved to "provide the best quality of humane care to hens."

Established businesses acknowledge the need for quality control after experiencing customer complaints, cost overruns or the production of too many unsalable, substandard finished goods. Unfortunately, owner-managers often find there are no associations they can turn to for assistance with quality control issues.

Quality control experts suggest that the first step to establishing quality control is to work out the exact specifications of the service or product to be produced. This logical (but all too often neglected) first step then determines the raw materials, personnel and knowledge required to create a quality control model.

Do not rely on inspection to ensure quality.

W. Edwards Deming's 14-Point Guide to Quality Control

W. Edwards Deming, an American statistician heralded as the foreign expert who did the most to make Japan a manufacturing giant after World War II, evolved a 14-point doctrine that suggested the road to quality control should use the following markers. (This list has been paraphrased because of space restrictions.):

1. Work constantly toward improvement in order to stay competitive, to stay in business and provide jobs.
2. Do not tolerate lack of quality, defects, inadequate training or poor supervision.
3. Do not rely on inspection to ensure quality.
4. Reward suppliers with long-term relationships that are built on loyalty and trust. Awarding suppliers on the basis of price is ineffective.
5. Work constantly to upgrade the system of production and service that will improve quality and production and reduce cost.
6. Establish on-the-job training.
7. Focus leadership on helping people and their equipment do a better job.
8. Do not let employees work in an environment of fear.

9. Eliminate interdepartmental rivalry and treat the whole organization as a team.
10. Rethink the design of your production facility or process. Poor quality and low productivity are the by-product of poor design. Pushing employees to improve quality and productivity without design improvement is counterproductive.
11. Manage increases in productivity rather than establish quotas that force individuals to produce more.
12. Reward quality, not quantity.
13. Establish a culture of education that in turn will foster an attitude of self-improvement.
14. Get all employees working together to accomplish the transformation.

General Guidelines

The following are general guidelines, not explicit instructions for the installation of procedures to achieve quality control. Nevertheless, as a philosophy, these ideas are valid, regardless of the type or size of business. But, without everyone understanding their part in the quality control process and supporting it enthusiastically, it will only flourish for a few months before languishing and then disappearing forever.

The benefits of quality control are both abstract and concrete:

- Products will meet customer requirements, thereby reducing customer complaints.
- Your business will become the "go-to" business.
- The cost of building a quality product will determine whether the market willingly absorbs the purchase price.
- Production quality is consistent.
- Liability is reduced.
- Reliability of product or service creates repeat customers.
- References from satisfied customers promote increased business.
- Product problems are identified quickly, thereby preventing recalls, delivery of replacements or total shut down of a product line.
- Built-in quality control may uncover product problems before production start-up, thereby averting loss from inferior products.
- Employees are happy knowing they have worked with the best to produce the best.
- Management and employees know that, if difficulties arise, the goal is: "Fix the problem; don't assign blame."

Build in Quality Control

Perhaps your business will need an expert to set up quality control procedures. Regardless of whether you hire an expert or institute the procedures with the help of your employees, built-in quality control will deliver the quality of products or service you need to ensure your business gets its fair share of the market.

MONEYSAVER

That's Where the Money Went

Record your revenues and expenses on a job-specific basis to better develop profitability

Annual, and even monthly financial statements, are not the only means of looking at a business's performance and financial condition. Neither record, however, is fine-grained enough to show the degree of detail you need in order to know your sources of revenue and expenses or for the evolution of your profit. This type of information can determine what jobs made money, the cost of labour, the cost of material and the cost of assigning capital assets to a job. Regardless of whether your business provides goods or services, recording the revenue and costs associated with each individual project will provide information helpful for estimating future projects. Although not all projects will be identical, typically the bookkeeping requirements will be similar.

Accounting software and programs developed specifically for spreadsheets are now available that allow owner-managers to review revenue and expense data sooner and faster, and thus exercise closer control over projects. Whether you use a spreadsheet or accounting software that allows information to be allocated by project, the secret is to gather as much detail as possible before starting the process.

Let's look at a few areas where allocation of information gathered from client and supplier invoices, or employee payrolls, may be useful.

Revenue Recognition

When a job is quoted, bookkeeping should be instructed to record the quote in the project file. When the project is billed, whether on a percentage-of-completion or completed-contract basis, the final sales figure should be entered. Comparison between final billing and the original quote is therefore available for management and staff to determine whether there should be improvements in the quotation process or whether there is room for discount on the next project.

Labour

Labour is undoubtedly one of the most difficult costs to track and record, especially when employees are involved in a number of different projects simultaneously. Employees must be encouraged to provide details of hours worked for each project on a time sheet. By assigning a code number to each project, the total hours worked on each project can be tracked for every pay period. Management will have to create guidelines to deal with unproductive time, such as travel time between projects, to ensure employee costs are fairly allocated. When the time sheets are submitted, payroll should allocate the cost, based on the hours worked on each project. Labour cost should include imputed CPP, EI, vacation pay and benefits accrued to the employee.

The invoice should indicate the project to which the purchase has been assigned.

Material and Outside Services

Material cost can be a frustrating area to deal with if purchasers do not indicate the project to which the materials and/or services have been assigned. To ensure correct allocation of costs, employees onsite and at central purchasing must indicate on the invoice the project to which the material is assigned. Once bookkeeping has received the invoices for recording in accounts payable, the cost can be allocated to the various projects.

Equipment

An hourly cost of equipment should be calculated. This standard hourly cost should include:

- cost of the equipment, divided by estimated useful life in hours (e.g., if the equipment cost $30,000 and has a useful life of 1,500 hours, then an hourly cost of $20 might be considered);
- estimated hourly maintenance;
- licences and permits;
- fuel; and
- transportation to and from the job site.

A day-to-day recording of project costs will enable management to see immediately any risk of cost overruns. The owner-manager can then take action to prevent the overruns or ensure the purchaser is aware of any that may have to be reimbursed under terms of the contract, if required.

If documentation is required, recording project costs provides proof to the purchaser that a percentage of completion payment is required.

Costing Equipment

Managing equipment costs by choosing the most appropriate equipment for the job is a combination of research before the purchase and reviewing the cost of operation and maintenance. Costs associated with similar equipment already used in your business can act as a purchasing guide. But, before you can review these costs, they have to be recorded. Costs that should be allocated to the equipment include:

- purchase price or lease;
- interest (if equipment is financed);
- maintenance;
- fuel;
- insurance;
- kilometres driven;
- sale or trade-in value.

As in any recording of data, those who use the vehicle or have the vehicle serviced must ensure the costs incurred are associated with the specific vehicle in order to allow allocation to the database. Such a data summary can provide insight into the cost of operating equipment and will assist in the decision-making process when the time to purchase or replace the asset is at hand.

The Whole Is the Sum of the Parts

Information that is not used is of no value. Thus, the value of maintaining detailed records lies in their use in the ultimate review of the elements that make up the total project. Knowing the sources of revenue and costs allows the calculation of gross margins and makes possible the prediction of future material, labour and equipment costs. Reference to the particulars of recent projects enables management to do a better job pricing the next project. For instance, if projects are coming in below management's goal of a 40% gross margin at year-end, study of the detailed records of the past year should make it easier to pinpoint areas for improvement. The records may show where labour is inefficient, material or subcontracts are too pricey, the wrong equipment was used or, if all those areas are in line, the selling price was too low.

Buy the Right Software

There are many software packages available to assist management in the detailed recording of project costs. Owner-managers should team up with their chartered professional accountant and determine project information that would be most beneficial, and then consider purchasing the accounting software or project management software best suited to their business.

The greatest benefit from examining the past is that it will assist in making positive changes that will improve the future of your business

BUSINESS MATTERS is prepared bimonthly by the Chartered Professional Accountants of Canada for the clients of its members.

Richard Fulcher, CPA, CA – Author; Patricia Adamson, MA, MISt – CPA Canada Editor.