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INDEX

TAXATION

Tax Benefits of Losses

Taxpayers may use losses to reduce their tax liability in the same, earlier or later taxation years, subject to certain limits and conditions. The limits and conditions largely depend on the character of the particular loss, with different rules applying to the particular type of loss.

This article discusses some considerations in the tax treatment of:

- Allowable capital losses;
- Allowable business investment losses; and
- Non-capital losses.

Allowable Capital Losses

You have an allowable capital loss when you sell, or are considered to have sold, a non-depreciable capital asset (say an investment or real estate) for less than its adjusted cost base plus the outlays and expenses involved in selling the property. In other words, the capital loss arises because the amount realized from the sale of the asset is less than its purchase price. The allowable capital loss is deducted against any taxable capital gains you have. Generally, one-half of the capital loss can be offset against one-half of the capital gain. However, allowable capital losses usually cannot be offset against other income sources, such as business income or earned income.

The adjusted cost base is usually the cost of a property plus any expenses you incurred to acquire it, such as commissions and legal fees. The cost of a capital property is its actual or deemed cost, depending on the type of property and how you acquired it. Cost also includes capital expenditures for additions and improvements. However, you cannot add current expenses, such as maintenance and repair costs, to the cost base of a property.

Some capital losses, such as the loss on personal-use property, cannot be claimed for tax purposes. For example, if you sell the family cottage at a loss, the loss will be denied for tax purposes.

Allowable capital losses can be used to reduce your taxable capital gains in the year the loss was realized, carried forward to future years or applied to previous gains. For example, if you sell a non-registered investment (one that is not held in your RRSP) at a capital loss and the loss cannot be used in the current year, the loss (referred to as a net capital loss) can be:

- Carried forward indefinitely to reduce the taxable capital gains in the future; or
- Carried back three years and applied to taxable capital gains in those years.

When you apply a net capital loss back to a previous year's taxable capital gain, it will reduce your taxable income for that previous year. However, your net income, which is used to calculate certain credits and benefits (such as the child tax benefit or the clawback of Old Age Security) will not change.

There are additional tax implications for a loss from the sale of a depreciable property (for example, a rental property). Certain rules on capital cost allowance (CCA) may require the recapture of CCA to be added to your income or allow you to claim a terminal loss.

Taxpayers are often remiss at providing their chartered accountant with sufficient documentation about capital acquisitions and dispositions to ensure that they can take advantage of any capital losses. To be able to claim a capital loss, you will need to keep careful records, including:

- A description of the capital property, purchase price and date of purchase;
- Documentation of any borrowings, including payments and interest charges, that were used to finance the purchase;
- Any costs incurred for the purchase of the capital property (legal fees, brokerage fees, transfer fees, etc.); and
- Documentation and details of the sale, including price, date and any costs incurred.

Allowable Business Investment Losses

An exception to the rule that capital losses cannot offset other income is an allowable business investment loss (ABIL). An ABIL can be applied to reduce the amount of other income subject to tax.

An ABIL is one-half of the loss on the disposition of shares or debt of a small business corporation.

To qualify as an ABIL, certain conditions must exist.

- The company must be a Canadian-controlled private corporation, where all or substantially all of the fair market value of its assets are used principally in an active business that is carried on primarily in Canada by the corporation or by a corporation related to it.
- The assets of the corporation can also include shares of, and/or a debt issued by, other eligible small business corporations or a combination of business assets, shares, and debt; and
- The corporation must have been a small business at any time in the last 12 months before the sale or loss.

There are many other conditions that must be met, for example, the sale must be to an arm's length person.

A loan made to a corporation, which becomes uncollectable, is considered an ABIL as long as the other conditions are met. This loss can be claimed when the debt is established to be a bad debt.

Non-capital Losses

Generally, a non-capital loss for a particular year includes any loss incurred from employment, property or a business to the extent that it exceeds your other sources of income for the year. An ABIL realized in the particular year is also included in your non-capital loss.

Non-capital losses can be carried back 3 years or carried forward 7, 10 or 20 years against any income in those years, depending on when the loss was realized.

The carry-forward periods are:

- For taxation years ending March 22, 2004 or earlier, 7 years.
- For taxation years ending after March 22, 2004, 10 years.
- For taxation years ending after 2005, 20 years.

The 20-year carry-over period for non-capital losses can be especially helpful for small businesses, as new enterprises often experience several years of losses during their start-up phase.

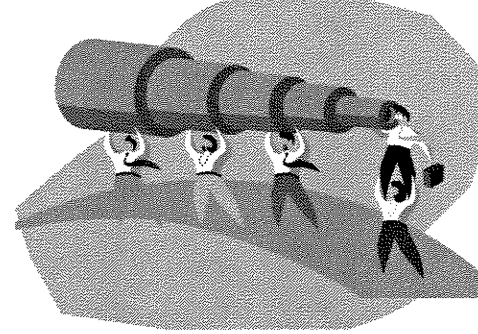
Note, however, that the 20-year carry forward does not apply to a non-capital loss resulting from an ABIL. Instead, an ABIL that has not been used within 10 tax years will revert to a net capital loss in the 11th year. After that time, it can only be applied against future taxable capital gains.

Before You Act

Individuals and corporations may be able to realize certain tax benefits to help offset the impact of capital and non-capital losses. However, while you may be tempted to gain some tax benefit from your losses, be sure to talk to your chartered accountant before taking any action. The tax treatment and implications can be very complicated. ■

Turning Prospects into Clients

Your initial contact with a prospect is an opportunity to gain a new customer. The prospect may have contacted you as a result of your direct marketing, a referral from one of your satisfied customers, your company's website or your listing in a telephone directory.



As part of the process of turning a prospect into a client, it is important to understand why and how they make buying decisions and what factors they consider when choosing an outside supplier. This article discusses the buying process and what you can do to improve your chances of influencing and winning a prospect's confidence and business.

Responding to Change

One of the catalysts for changing suppliers of products or services is a change in the business's operations or requirements. These changes can come about for a number of reasons — increased competition or costs, new needs or dissatisfaction with an existing supplier.

Dealing with an Issue

Once an organization has decided to seek some assistance, management will start to investigate potential ways of solving their problem or meeting their need. In many cases, they will have a series of meetings with one or more preferred or selected suppliers. These meetings are often used to help them with their own thinking and estimate the potential costs and time frames as well as the resources required to deal with the problem.

The Selection Process

Some organizations may ask a preferred supplier for a quote to supply the product or do the work; others may ask for formal proposals from a number of potential suppliers and then select the one that best meets their needs.

How You Can Influence the Buying Cycle

Once you are aware of an opportunity to provide a product or service to a potential client, the most important thing to do is to establish rapport and begin the process of building trust.

During the prospect's investigation stage, it is important to maintain close links with the prospect and do everything you can to foster a continuing dialogue. Most buyers prefer to award the work to a person where some kind of personal chemistry has been established. If you have been able to develop sufficient rapport and trust with the prospect, he or she may well decide only to involve a single supplier — you.

In cases where the business is required to go through a competitive bidding process for products or services, it may be possible to gain an advantage over the competition by offering to help the prospect draft the Request for Proposal document (RFP) and the supplier selection criteria. In many cases, the company that assists with drafting the RFP is the one selected for the work.

The speed with which a company moves through the buying cycle can vary significantly, as can the length of time spent at each particular stage. Also consider that outside suppliers can enter the buying cycle at different stages in the process. Clearly, the earlier in the cycle you can become involved, the more likely you are to win the client's business.

Tips When Meeting a Prospect

When you meet with a prospect, here are some techniques that can help you turn a prospect into a client:

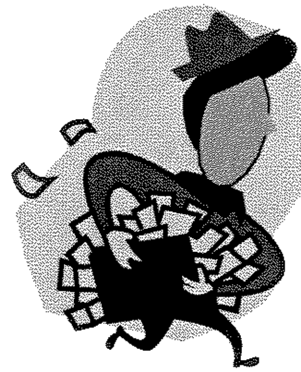
- Maintain good eye contact and show interest and friendliness;
- Use body language, such as gestures and posture, to communicate your enthusiasm;
- Paraphrase the other person's comments to indicate you are paying close attention; and
- Actively listen and ask probing questions to clarify any concerns.

People Buy People First

The most successful business development activities occur when you can establish a good rapport with the prospect. Keep in mind the old adage, "people buy people first". If you can make the buyer see you as someone with whom they can work and feel comfortable, you will be in a strong position to gain a new customer. But even if you are not chosen this time around, you should continue your efforts to maintain a good relationship with the prospect to ensure that you will be asked to bid on future business. ■

Preventing Theft

Theft comes in many guises – shoplifting, pilfering, burglary and robbery – to name a few. How much is theft costing your business?



The implementation of effective theft control procedures is a sound business investment. It is far less costly to prevent a crime than to deal with it after the fact. Here are some security measures that can help you reduce the risk of theft.

Access

- Install an alarm (preferably both audible and monitored).
- Have a designated person (or persons) open up and lock up your premises at the start and end of the business day. Restrict the number of individuals who have the security alarm access code.
- Secure all office doors, windows, desks and file cabinets each night.
- At the end of day, the last person to leave should routinely check that all office and plant areas are secure before activating the security alarm.
- Install and use adequate exterior and interior security lighting.
- Maintain strict key control access and designate a person to maintain a log detailing the issue and return dates of keys and the name and signature of recipients.
- Ensure keys are always kept in a secure place. Never label them with a name and address or building/room number.
- Establish a procedure for collecting keys from employees who are terminated or leave for any reason.
- Keep cash on the premises to a minimum and keep it secured – for example, in a safe.

Visitors

- Make eye contact and greet everyone who enters your business.
- Maintain a visitor log book, issue visitors' tags and limit access to certain areas and hours of the day.
- Have the person with whom visitors are meeting come to the reception area and escort them to the meeting area.
- Never assume that a stranger wandering in the office or building is a client, staff member or service provider. Politely ask, "May I help you?"
- During lunchtime and meetings, make sure a staff member is on hand to question visitors who enter the office or building.
- If a full-time receptionist cannot be fiscally justified, install a restricted-use telephone, internal telephone directory and appropriate signage outside the access door.
- Do not disclose information about your social life or vacation plans and those of your co-workers to people visiting or calling your business.

Intellectual Property and Other Sensitive Data

- To help prevent theft of proprietary information, establish a 'clean desk' policy. Sensitive or classified information should be placed in locked cabinets or desks every night.
- Shred paper documents containing sensitive information. Do not discard in the trash or the recycling bin.
- Lock up company letterhead and business cards to prevent use by unauthorized people.
- Establish and enforce policies for password confidentiality and other security measures for protecting computer data and applications.
- Restrict computer access to sensitive information and maintain an access log. Base each employee's level of access on his or her job description.

Personal Belongings

- Do not leave valuables, purses or wallets on desks. Lock them in a drawer or cabinet or take them with you.
- In plant areas, provide lockers with keys or combination locks for storage of personal belongings.

Equipment and Supplies

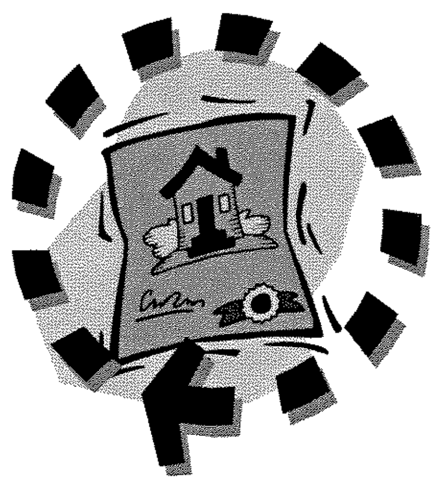
- Place the company's name or some identification number on all company-owned items, e.g., office equipment, tools and machinery. This can be done by engraving or etching, or by using a permanent adhesive.
- Retain inventory records of equipment serial numbers, values and dates of purchase.
- Designate an individual to be responsible for issuing and keeping track of office supplies.
- Lock up the postage meter, cheque writer and company cheque books when they are left unattended.
- If you have a safe or a special security room for valuables, make it a rule to keep it locked even during business hours.

Reducing the opportunity for the theft of funds and assets is an ongoing responsibility for everyone in the company. It is also a very important consideration when you modify or develop business processes and procedures. Your chartered accountant can provide knowledgeable advice on your company's policies and procedures for minimizing the risk of loss from theft. ■

PERSONAL FINANCES

Reverse Mortgage

Fast cash and no monthly payments – for the "home rich but income poor" retiree, the reverse mortgage may be a viable way to ensure you have adequate income to live the lifestyle you want, or to pay for the upkeep of your home.



A reverse mortgage is a loan against the homeowner's accumulated home equity that requires no repayment for as long as the person or his or her surviving spouse or common-law partner lives in the home. The homeowner mortgages part of the value of the home, receiving the proceeds as cash or a line of credit or as an income-producing annuity. But instead of making monthly payments on the principal and interest owing under the mortgage, the interest is allowed to accumulate.

The borrower continues to own his or her own home and is fully responsible for property taxes, fire insurance premiums, condominium maintenance fees, maintenance and repairs of the property. Title to the property remains in the homeowner's name and the owner retains the right to decide when to move and when to sell.

The loan plus interest is paid back when the borrower dies, sells the home, or permanently moves out of the home. Because the borrower makes no regular payments, the amount owed grows larger over time.

Estate Planning

In the case of a couple, when one spouse dies, nothing changes. Upon the death of the surviving partner, the home becomes part of the estate in the usual manner and the estate repays the loan as it would repay any other outstanding debts. If the senior is a single homeowner, the home becomes part of his or her estate when he or she passes away and the full amount due on the reverse mortgage is paid by the estate.

The homeowner may leave the home as a gift to a beneficiary through a will. However, the beneficiary then becomes responsible for repaying the full amount due on the reverse mortgage. This amount can be repaid from other funds in the estate or by a traditional mortgage or other type of loan, or by any other means that the beneficiary chooses.

The loan amount to be repaid is guaranteed not to exceed the fair market value of the home at the time it is sold. In the event that the net proceeds from the sale of the home are not enough to repay the reverse mortgage in full, the repayment is limited to the amount received from the sale of the home. If the proceeds from the sale of the home exceed the balance on the loan, the estate retains the excess.

Eligibility Requirements

You must be 60 years of age or over. If you own your property with a spouse, both of you must be 60 or over.

You can receive up to 40% of the value of your home. Currently, this can range from a minimum of $20,000 to a maximum of $500,000. The specific amount is based on your age and that of your spouse, the location and type of home you have and your home's current appraised value

The reverse mortgage must be registered as a first mortgage on title. Any conventional mortgage or other home-secured borrowing, including a secured line of credit, must either be paid off or moved into second place. The proceeds from a reverse mortgage can be used to retire these loans.

Interest
Interest is added to the outstanding balance and is compounded semi-annually. You have the option to pay all or part of the accrued interest once every calendar year. Fixed interest rates are available for six-month, one-year, three-year, or five-year terms. The variable rate option has no fixed term and is based on the current bank prime rate.

Proceeds
The proceeds from a reverse mortgage are a loan and not taxable income. As a result, the money has no impact on any income-tested government benefits, such as the Guaranteed Income Supplement, and it will not result in a higher income tax bill.

Costs
There is no cost for requesting a reverse mortgage estimate but, if you wish to proceed beyond an estimate, a fee is required to cover the costs of the appraisal of the home. You will also have legal fees. Before you sign the final reverse mortgage contract, you are required to obtain independent legal advice. Finally, there are closing costs, which are deducted from the proceeds at the time of funding and cover the costs associated with obtaining a mortgage, such as title insurance and registration on title.

Consider also that reverse mortgages are subject to higher interest rates than most other types of mortgages. Unlike traditional mortgages, you do not make any regular or lump-sum payments on a reverse mortgage. Instead, the interest on your reverse mortgage accumulates and the equity that you have in your home will decrease with time.

Before You Act
If you need cash and are considering a reverse mortgage, be sure to check all your options carefully and get professional advice. Remember the key to making the right decision is always good information.

Compare the current interest rates of a traditional mortgage versus those of a reverse mortgage. Consider other options, such as:

- More conventional sources of funds (e.g., a line of credit with the house as security or renting out part of your home);
- Selling the home and moving to a smaller home or rental accommodation. If you can free up some equity by selling your house, you may be able to invest the proceeds, live on the investment income and still have something to leave your children.

Realistically assess your financial resources, the ongoing costs of homeownership and your desired lifestyle. Make sure you are not trying to live beyond your means.

Get Professional Advice
Reverse mortgages are complex and binding financial instruments. Be sure to talk to your chartered accountant about the impact that your decisions will have on your retirement income, your lifestyle and your estate planning wishes. ■

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