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TAX DEDUCTIBLE BUSINESS EXPENSES

The Income Tax Act allows most common operating expenses to be deducted from taxable income provided they are laid out to gain or produce income, but there are many exclusions and limitations. While not all-inclusive, following is a list of some common business expenses, and some that may not be quite as well known.

Cost of Goods Sold

Cost of goods used to produce products you sell, including freight, brokerage, labour and supplies.

Marketing, promotion, and advertising costs

Under this category fall some items with restricted deductibility:

- Meals and entertainment of clients (such as tickets to a concert): **50%** of the expense only is deductible.
- Golf green fees, club dues for use of facilities the main purpose of which is to provide "dining, recreational or sporting facilities" to its members or fees paid for the maintenance of a "yacht or lodge": **None** of the expense is tax deductible.
- Advertising in United States media that is directed primarily at a market in Canada: **None** of the expense is tax deductible.

Operating expenses

Most common expenses such as office supplies, wages, rent, etc. are fully deductible for income tax purposes.

Items subject to specific rules include:

Capital or Fixed assets - Items such as computers, machinery and equipment, vehicles and buildings are all subject to capital cost allowance (CCA) restrictions (think depreciation), which allow only a percentage of the original cost to be deducted each year. This is another of those areas where taxpayers and Canada Revenue Agency (CRA) are often at odds: business owners would rather "write off" large repairs, equipment or small tools, cell phones, etc., while the taxman wants you to "capitalize" and deduct these items over a period of years. The correct treatment depends on the circumstances, and is sometimes more subjective than concrete. Examples of items subject to capitalization rules and the rate at which they can be depreciated are:

Vehicles:	30%	Manufacturing equipment:	30%
Machinery and equipment:	20%	Furniture and fixtures:	20%
Computer hardware & printers	30% & 55%	Buildings:	4%, 6% or 10%

The above are all computed under the declining balance method, with one-half the normal rate of CCA being allowed in the year of purchase, and thereafter the specified percentage being calculated annually on the remaining balance.

Other common items depreciable evenly over a number of years include leasehold improvements (over 5 years or the term of the lease, if greater) and computer software (over 2 years).

Franchise fees are deductible over the life of the agreement if paid for a franchise with a limited life; otherwise they are deductible under another set of rules as "eligible capital property". Other items included under the eligible capital property rules are things such as goodwill, purchase of customer lists, incorporation costs and trademarks.

Automobile expenses - a favourite area for Canada Revenue Agency (CRA) auditors, automobile expenses must be carefully documented if you have any personal mileage at all (use a log book to track business mileage). There are limits on the cost of company automobile purchase, lease and interest costs. - Currently \$30,000 plus GST and PST, \$800 per month and \$300 per month respectively (actual limits may be less depending on technical calculations).

If you use your personal vehicle for business use and receive an allowance from your company, it must be based solely on kilometers driven to be tax-free to you. Any other form of payment is deemed taxable to the individual (although the owner can then deduct expenses against this if in receipt of a T2200).

Other expenses and deductions

Owners and directors salaries - Another favorite area of audit for CRA is how and when an owner receives money or other consideration from his corporation has long been an area of much litigation and fancy stick-handling by owners and their advisors. Essentially, if you take money out of your company it must be declared as either a dividend or salary, unless you previously loaned funds to your company, or have other tax-free balances owing to you - for example, a balance in the company's capital dividend account can be paid to the shareholders upon approval by CRA (capital dividends are built up from things such as the non-taxable portion of company capital gains). Even if you believe you have only "borrowed" funds from your company, you may find out the Income Tax Act deems you to be taxable on these amounts.

There are also sections in the Act that deal with taxing "shareholder appropriations" - benefits or items of value you have the company pay for you or on your behalf - e.g. building a shop on your personal residence property and paying for it through the business is considered to be a personal, taxable event to the shareholder. Other oft-tried but seldom-successful appropriations include company owned boats, aircraft, vacation condos or houses, and company paid vacations. For example, if the active shareholder takes his non-active shareholder spouse on a business trip, the spouse's portion of the trip will not be deductible. Get caught at any of these little tricks and you will find out just how heavy a hammer the government wields. On audit these goodies can be denied as a business deduction, and included on your personal return, resulting in double taxation. Add to that interest and penalties when prior year's personal returns are reassessed, and you will see how quickly the amount you pay to CRA can exceed the original "expense".

Some other deductions which are sanctioned:

- Private Health Services Plans – self-funded arrangements set up by a *corporation* to pay for eligible medical and dental expenses, provided the company has employees other than the shareholders and their dependants and benefits are available to other employees.
- Premiums paid by an *un-incorporated business* to a private insurer, for health and dental plans (subject to certain restrictions).
- Life insurance - if required by a lending institution to secure a loan.
- Travel to a maximum of two conventions per year.
- Interest paid on funds loaned to the corporation.
- Home Office Expenses – provided you use your home as your principal place of business or you use an exclusive area of your home on a “regular and continuous” basis to meet customers. Note an individual cannot deduct home office expenses that create or increase a loss.

One last thing: if you run an unincorporated business (partnership or proprietorship), you may not be allowed to deduct business losses if there is any personal element or benefit associated with your business. For example, if your business involves renting out a motorhome, and you use the motorhome for a family vacation, CRA may take the position that your losses are not deductible. If, however, your business does not have a personal element to it, CRA cannot normally challenge this.