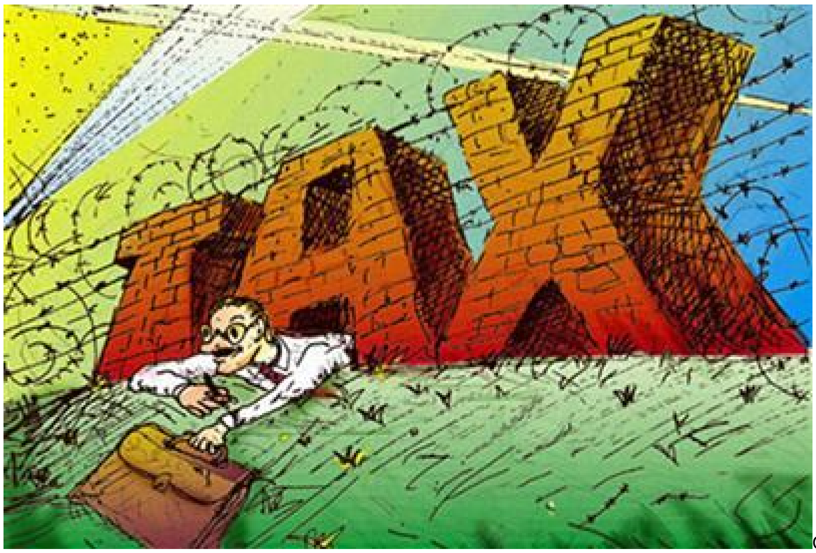
FINANCIAL POST

Tips to ease pain of paying the piper

Take steps now to reduce effects of rule changes



Getty Images In Canada

Ontario's heath tax, Green Energy Act and the adoption of the harmonized sales tax are signs of things to come.

Brad Cherniak, Financial Post Published: Monday, January 11, 2010

The well-publicized dearth of capital is only one element of the growing challenge small to mid-sized businesses are facing in managing their cash flow going forward. Another looming maelstrom is taxes.

The economically suicidal fiscal positions of governments worldwide, including in Canada and the United States, will lead to greater challenges for everyone: Big and small businesses, their owners and customers. Financial Post columnist William Hanley recently noted the collective government deficit in Canada this year and each year for the foreseeable future will exceed $100-billion … and we are in good control relative to the United States and overseas.

But the piper will have to be paid for this recession-induced collective insanity, fuelled by the disappearance of basic principles and common sense from political and business leaders — and the alarming erosion of political thought to dime-store populist positions.

The darkest clouds are only beginning to gather for small businesses: The United States is considering raising capital gains tax rates, upper-income surcharges and health care and environment-related levies to punitive levels. In Canada, Ontario's heath tax, Green Energy Act and the adoption of the harmonized sales tax are signs of things to come.

Most worrisome is that none

of these measures comes close to covering the tab for governments' spending madness. Meanwhile, Canada is being pressured by the International Monetary Fund to continue its stimulus spending until a "recovery is firmly established."

There is little political will in either country to cut spending and entitlements. Instead high-income earners are being asked to carry a burden far too large: Their effective tax rate could be 100% and still not close the deficit gap. With few alternatives, business tax rates will ultimately rise substantially.

Here are a few tips to help plan for the inevitable: – Budget something into financial forecasts, including personal financial planning. Raise marginal tax rate assumptions and, as always, create cushions for contingencies. Rising costs will increasingly affect already tight net free cash flow.

Jordan Gould, partner and small business specialist at Toronto-based accounting firm SBLR LLP, says corporate and personal income tax rates are in a constant state of flux, and look set to rise, at least short term. Federal and provincial legislation recently passed or awaiting final reading has mapped out personal and corporate tax rates to 2014.

As a result, Mr. Gould says, owner/manager remuneration is becoming a vital component of small business tax planning. In Ontario for example, the small business tax rate will fall to 15.5% by 2011, from 16.5% now. The top marginal tax rates on eligible and non-eligible dividends, however, will jump to 29.54% and 32.57 %, respectively, from 23.06% and 31.34%. The top marginal rate on salaries will remain at 46.41%. This means, choosing between dividends or bonuses, retaining profits in the business or paying them out, will get more difficult. – Plan for the HST. Cyndee Todgham Cherniak, counsel at Lang Michener LLP, specializing in GST/HST and trade law, says it used to be "the GST tail did not wag the income tax dog." But, with the reduction in corporate and personal income taxes and the move to HST, the combined liability is now more significant.

She says some of the traditional methods of extracting funds from a business will become subject to the tax. Owners who sell their businesses this year and structure partial consideration as an earn-out and continue to provide services as an independent contractor, may see sales tax consequences, Todgham Cherniak says.

If HST is not addressed in the sales agreement, they may be required to self-assess and remit a portion of the payment to the Receiver General as GST/ HST (13/113, or about 13%, in Ontario and 12/112, or about 12%, in British Columbia).

If you sign an agreement after May 1, 2010, and plan to transfer the assets or services after July 1, HST may be applicable on the sale.

"Do everything you can to get ahead of the tax curve by properly planning and taking advantage of available opportunities and avoiding negative HST consequences," Todgham Cherniak advises.

For example, while many businesses are entitled to claim input tax credits and recover HST paid, out-of-pocket costs will rise because the tax will apply to expenses previously not subject to provincial sales tax, such as commercial rent, electricity, inventory for resale, materials, production equipment and machinery and intellectual property . Not all businesses are entitled to recover all HST paid she warns. Ontario, for example, will consider businesses with sales of more than $10-million to be big companies and as such subject to restricted input tax credit rules until 2015.

Tax planning should never impinge on operating cash flows or exacerbate business risk by, for example, structuring sales contracts to defer revenue to the next tax year or deferring collection of receivables. North America's high bankruptcy rate makes this a bad time to take on more customer credit risk. Cash in hand, even highly taxed, is better than none at all.

The upshot is small businesses will continue to feel the squeeze of financing supply constraints as capital requirements rise, in part, to cover the impending growing tax bills .

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