Playing It Safe

big money *Why your books are much better served raw than cooked.*

By Scott Taylor

How much tax did you pay during 2005? If you're an employee, you may not have known until you picked up your T4 slip. That's because your employer deducts your Canada Pension Plan (CPP) contributions, Employment Insurance premiums, and income tax from each paycheck. If you're like most people, you're far more interested in the box that shows your annual salary.

The self-employed, meanwhile, tend to have a different take. If you're self-employed you have to record all your income and expenses and pay tax in quarterly instalments. You're writing a check to the government every three months, so you're keenly aware of how much tax you've paid.

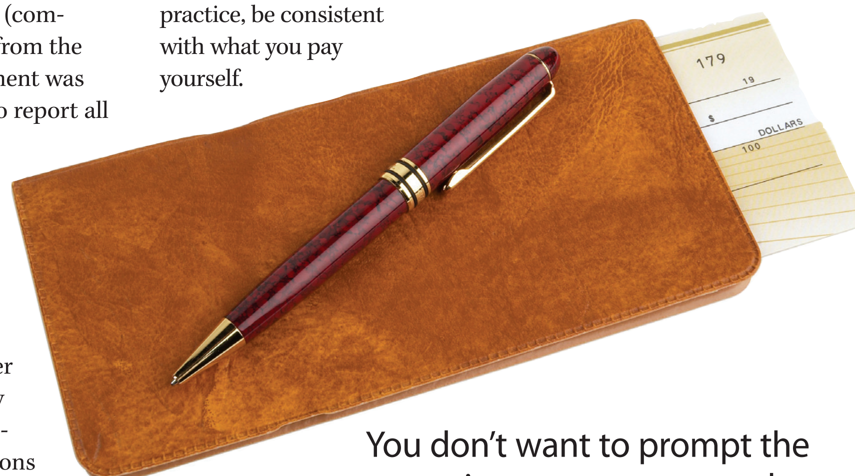
Like a blowhard salaryman bragging about the size of his paycheck, occasionally you'll hear a self-employed truck driver yammering on about how he pays little or no tax. If that's really the case, he made no more than $3,500 last year. Tough to get financing on a new truck or mortgage with that, let alone feed the family.

Now, our taxation system is progressive, meaning the more you earn, the more you pay. As an accountant, I can draw up a strategy to help you reduce your tax liability and ensure that you're taking advantage of every available deduction. But whether you pull a salary from a corporation or earn income as a sole proprietor, there's no escaping your legal obligation to report all your income to Canada Revenue Agency. Lowball it and you may face consequences you really can't afford:

- Penalties. If you don't send in your instalments and you end up owing that amount in income tax, you'll be charged interest (compounded daily) from the day each instalment was due. If you fail to report all your income, the penalty can be 10-percent on the amount you didn't report and you may be penalized further if you knowingly made false statements or omissions on your tax return.
- A crimp on your retirement fund. Your CPP and RRSP limits are based on income. No tax bills means no CPP paid in—and no CPP upon retirement. CPP also pays out upon your death or disability. These future potential pension incomes to you or surviving family would also be reduced.
- Increased audit exposure. CRA auditors look for non-compliance, undisclosed income, and inconsistencies or unusual patterns. If something looks out of whack, your return may get kicked up the chain for further scrutiny. You don't want to prompt the person processing your return to ask a supervisor whether something "looks right."

A BETTER PLAN

I know your income can fluctuate. Sometimes you have to cut your pay in order to help keep your business afloat. Other times you're flush from an influx of business. As a best practice, be consistent with what you pay yourself.



You don't want to prompt the person processing your return to ask a supervisor whether something "looks right."

Set your annual compensation according to how much it costs to run your household each month. Tally up your personal expenses, mortgage payment, property taxes, groceries, insurance, clothes, vehicles, etc. Add it up and multiply by 12 to cover the year. That's your annual personal income target, one you can use as the basis for quarterly instalments.

The interesting thing about it is that you'll owe roughly the same amount as an employee with a similar income. Let's assume that number is $30,000. On $30,000 net income, a self-employed person in Ontario will pay $4,300 in tax and $2,630 in CPP. An employee earning that same $30,000 a year will have deductions from their paychecks totaling to the same amount of tax, half the CPP (about $1,315), and EI of $600.

Finally, with tax season in full flight, remember this if you're tempted into some creative accounting in order to save tax. For every tale told about a trucker who pays no tax, there are concrete examples of what happens when you evade your income tax or GST/HST obligation.

Check out a list of CRA tax court convictions here: www.cra-arc.gc.ca/newsroom/convictions/menu-e.html. ▲

Scott Taylor is Vice President of TFS Group of Waterloo, Ont. For more information visit www.tfsgroup.com or call 1-800-461-5970