Tax Talk

Your business needs its own bank account

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Recently, we had two new clients come to us with similar problems. First, they got bad advice from their previous accountants, and second, they were using a single bank account to handle all of their business and personal finances.

If you're a sole proprietor and want one bank account for everything, that's fine. I don't advise it but legally, you're okay.

But these clients are incorporated. A corporation is its own legal entity, and revenues, expenses, assets, and liabilities need to be properly separated from your personal finances, even if you're the only shareholder.

Imagine the Canada Revenue Agency (CRA) auditors' first impression when they see your corporate bank account statements full of mortgage payments and withdrawals for groceries, clothing, and liquor. Their hair is going to stand up on the back of their necks as they assume you are claiming some or all of these items as business expenses. They'll be on high alert as they review your returns.

Your bookkeeper will have a similar reaction.

Why are you paying me and using my time to wade through your personal charges and record them to a drawings account? What if I make a mistake and misallocate a business item as personal or a personal item as business? Pretty easy to do when it's all mixed together.

If you want to make me and CRA happy, maintain two bank accounts and transfer lump sums of money from the business into your personal account.

Keeping things separate does take discipline and a little more work but it's worth it.

Having separate bank accounts will help you keep two budgets, one for your business and one for your personal needs.

A shareholder may, in the course of running the business, make purchases or pay expenses with their own money on behalf of the corporation. When this happens, write a check to reimburse yourself so now you have a clear trail showing the company paid for the items.

When the corporation is being formed or is low on cash, it's best that you loan the company money rather than paying for items yourself. You should deposit into the corporate bank account the $1,000 or $10,000 that the company needs. That way all receipts will be clearly paid by the company and just as importantly invoiced to the company.

The corporation will then owe the full amount back to the shareholder. When it's paid it is tax-free because it is a loan repayment and clear and easy for CRA auditors to follow. If you used your line of credit or credit cards to loan this money then you can charge any interest charges back to the corporation.

Essentially, if these expenses are forgotten, you will end up paying additional tax for both the corporation and personally. This is because these items will not be deducted from your taxable income in the corporation, and when you take money out of the business you will be taxed on it as a draw rather than receiving it as a loan repayment.

Too many times I have seen where clients think their company still owes them money from when they initially lent it funds. Unfortunately, their previous accountants have shown on the books that this money was repaid already by reducing their wages taken in a particular year.

Having separate bank accounts will help you keep two budgets, one for your business and one for your personal needs. Your personal budget is a good tool in determining the amount of money you require from your business, while the business budget will determine whether it is able to pay it. Without a home budget and set transfers from the business to your personal account you'll just end up spending everything. Then you and I will have a long phone call about why your personal taxes are so high because there's no way you spent that much money.

Incorporating is the best way to bring order to your personal and business finances. Step one is to have two bank accounts. Step two is to get good advice from your accountant about how to set them up right. **TN**