Canada Revenue Agency   Agence du revenu du Canada

Small Business Information Seminar

Module III
Income Tax

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Canada

In this publication, we use the name "Canada Revenue Agency" and the acronym "CRA" to represent the Canada Customs and Revenue Agency. This reflects recent changes in the structure of the Agency.

La version française de cette publication est intitulée *Séminaire d'information pour les petites entreprises – Module III : Impôt sur le revenu*.

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Introduction

This module is part of a package designed primarily for small business entrepreneurs. It is intended to help those who are about to get started in business, as well as those who have just begun a business.

The information is divided into three parts:

Part 1 – Starting Your Business

Part 2 – Rights and Obligations

Part 3 – Income and Expenses

The information covers a wide range of business situations and is general in nature.

For more specific information from the Canada Revenue Agency (CRA), visit our Web site at **www.cra.gc.ca** or by calling **1-800-959-5525**.

Many of our publications are also available on our Web site at **www.cra.gc.ca/formspubs** or by calling **1-800-959-2221**.

Part 1 – Starting Your Business

This part gives you information on the different types of business formations, the minimum requirements for maintaining and keeping books and records, various accounting methods, and fiscal periods.

1. Types of business structure

As the owner of a small business, you can choose from three main types of organizational structures. You can operate your business as a:

- Sole proprietorship
- Partnership
- Corporation

The type of structure you choose has a significant effect on the way you report your income, the type of returns you complete each year, and many other matters. One of your most important concerns will be your liability for business debts.

Sole proprietorship

A sole proprietorship is an unincorporated business that is owned by one person. It is the simplest form of business organization. A sole proprietorship may have some of the following features:

- The owner has the sole responsibility for making decisions.
- The owner receives all the profits.
- If the business incurs a loss, it may be deductible from the owner's other sources of income.
- The business does not have a separate legal status.

When operating as a sole proprietorship, the owner assumes all the risks of the business. The business does not exist apart from the owner. Even the owner's personal property is at risk in a sole proprietorship.

As a sole proprietor, you have to register for the goods and services tax/harmonized sales tax (GST/HST) if your taxable annual sales are more than $30,000. If you operate more than one business and you have legal ownership of each, one registration will cover all of your businesses.

Partnership

A partnership is an association between two or more persons who join together to carry on a trade or business. Each co-owner or partner contributes money, labour, property, or skills to the partnership. In turn, each partner is entitled to share in the profits or losses of the business.

A partnership may have some of the following features:

- It is easy to form.
- An individual partner's share of the income is taxed at the partner's tax rate.
- A partner's share of any losses may be deductible against other sources of income.
- The partnership is bound by the actions of any member of the partnership, as long as these are within the usual scope of the operations.

The business profits or losses will be divided among the partners, based usually on a partnership agreement. A partnership agreement is a document that sets out how the business will be run. This agreement may be verbal but, because of its importance, it is best to have it in writing.

A partnership does not pay income tax on its operating profits and does not have to file an annual return. Instead, each partner files an individual return annually and includes a share of the partnership income or loss. This must be done whether or not the partner actually received the allocation in money, or in credit to a partnership capital account.

If you are a member of a partnership, you are not entitled as an individual to register for GST/HST for the activities of the partnership. The partnership, and not the individual partners, must register for GST/HST as a single entity.

Generally, partnerships that have five or fewer partners throughout the whole fiscal period, and that have no partner who is another partnership, do not have to file a partnership information return.

Corporation

A corporation is a separate legal entity. In law it is an artificial person, separate and distinct from its owners. It has the right to enter into contracts and own property in its own name, as a person separate and distinct from its owners.

A corporation may have some of the following features:

- It is a separate legal entity with a perpetual existence.
- It can generally raise larger amounts of capital more easily than a sole proprietorship or partnership.
- It is adaptable to both small and large businesses.
- The shareholders cannot claim any loss the corporation sustains.

When forming a corporation, the owners transfer money, property, or services to the corporation in exchange for shares. The owners are referred to as **shareholders**.

You can buy and sell shares in a corporation without affecting the corporation's existence. A corporation continues to exist unless it winds up, amalgamates, or surrenders its charter for such reason as bankruptcy.

The shareholders have limited responsibilities; they are not responsible for the corporation's debts. Although this limited-liability feature is often the strongest reason for incorporating, it may only apply in a limited way in smaller, closely held corporations. This is because the banks and creditors of smaller corporations usually require personal guarantees from the major shareholders. As a result, the owners will still find themselves personally liable for the corporation's debts.

The *Income Tax Act* considers a corporation to have a separate legal existence. A corporation has to file a return, and is subject to tax on its income. The corporation must also register for GST/HST if its taxable annual sales (including those of associates) are more than $30,000.

There is no single rule to follow when deciding whether to operate as a proprietorship, partnership, or corporation. Ultimately, you will have to analyze your own business situation and determine which alternative is best for you. You may also want to re-evaluate your alternatives as your business grows or changes over the years.

You set up a corporation by filling out an article of incorporation, and filing it with the appropriate provincial, territorial, or federal authorities.

2. Bringing assets into a business

Fair market value (FMV)

You may find yourself in a situation where you would like to take assets that belong to you personally and transfer them to your business.

If you are operating a sole proprietorship, this is a reasonably simple process. The *Income Tax Act* requires that you transfer these assets to the business at their FMV. This means that we will consider you to have sold these assets at a price equal to their FMV at that time. If the FMV at the time of the transfer to the business is greater than your original purchase price, you must report the difference as a capital gain on your income tax and benefit return.

You can claim a GST/HST input tax credit based on the basic tax content of the assets you transfer to your business, providing GST/HST was paid on the original acquisition of the particular asset.

Your business will show a purchase of these assets, with a cost equal to the FMV at the time of the transfer. This is the value that you will add to the capital cost allowance schedule for income tax purposes.

For income tax purposes, when you transfer a property to a Canadian partnership or a Canadian corporation, you may transfer the property to the partnership or the corporation for an elected amount. This amount may be different from the FMV, as long as you meet certain conditions.

The elected amount then becomes your proceeds for the property transferred, as well as the cost of the property to the corporation or partnership. For detailed information on transfers of property, get Interpretation Bulletin IT-291, *Transfer of Property to a Corporation Under Subsection 85(1)*, Information Circular 76-19, *Transfer of Property to a Corporation Under Section 85*, and Interpretation Bulletin IT-413, *Election by Members of a Partnership Under Subsection 97(2)*.

These rules also allow you to change your business type from a sole proprietorship to a corporation or partnership, or from a partnership to a corporation, on a tax-free basis.

Buying an existing business

When you are considering becoming a business owner, you will find that you have the option of either buying an existing business or starting up a new business. The option you choose will have a significant effect on how you account for the purchase of the business assets for income tax purposes.

When you buy an existing business, you generally pay a set amount for the entire business. In some cases, the sale agreement sets out a price for each asset, a value for the inventory of the company and, if applicable, an amount that you can attribute to goodwill.

If the individual asset prices are set out in the sale agreement, and the prices are reasonable, then you should use these prices to claim capital cost allowance.

If the individual asset prices are not set out in the contract, you have to determine how much of the purchase price you should attribute to each asset, how much to inventory, and how much, if any, to goodwill. These amounts should coincide with the amounts the vendor determined when reporting the sale.

The amount you allocate to each asset should be the fair market value (FMV) of the asset. You should allocate to goodwill the balance of the purchase price remaining after you allocate the FMV to each asset and to inventory.

Example

You purchase a business for a total purchase price of $120,000. The FMV of the net identifiable assets of the business is as follows:

Accounts receivable	$ 20,000
Inventory	10,000
Land	30,000
Building	50,000
Total	**$110,000**

You can determine the value of the goodwill by subtracting the total value of the net identifiable assets from the purchase price.

Purchase price	$120,000
Minus net identifiable assets	110,000
Amount attributed to goodwill	**$ 10,000**

Once you have determined the values for the assets and the goodwill, add the fixed assets (e.g., buildings and equipment) into the appropriate classes for the purpose of claiming the capital cost allowance. The goodwill is considered to be an eligible capital expenditure, which is treated the same or similar to capital cost allowance.

Treat the value of the inventory as a purchase of goods for resale, and include it in your income statement at the end of the year as the cost of goods sold. For detailed information about the treatment of inventory and eligible capital expenditures, see Part 3 of this module.

For GST/HST purposes, if you buy a business or part of a business and acquire at least 90% of all the property than can reasonably be regarded as necessary to carry on the business, you and the seller may be able to jointly elect to have no GST/HST payable on the sale by completing the form GST44, *Election Concerning the Acquisition of a Business or Par of a Business.* The election can only be made by:

- a registrant when selling to another registrant; or
- a non-registrant when selling to either a registrant or a non-registrant.

In addition, you must buy at least 90% of the property, and not only individual assets.

Usually, for the election to apply to the sale, you have to be able to continue to operate the business with the property acquired under the sale agreement. The purchaser has to file the election (GST44) with us no later than the due date of the purchaser's next return in which tax would have been payable if the election had not been made.

Another way of buying an existing business is to buy the shares of an incorporated business. This does not affect the cost base of the assets of the business. As explained previously, a corporation is a separate legal entity and can own property in its own name. A change in the ownership of the shares will not affect the tax values of the assets the corporation owns.

Starting a new business

When you start a new business, you will be purchasing your business assets separately, as opposed to purchasing all the assets together as a functioning business. This makes accounting for the purchases quite simple, since you should have a separate purchase price for each asset.

Once you have determined the purchase price for each asset, you can use these prices to claim capital cost allowance. We explain this in detail under "Capital cost allowance" in Part 3 of this module.

You can claim an input tax credit for GST/HST you paid, or that was payable, on capital property you acquire to use primarily (more than 50% of the time) in a commercial activity.

3. Registering your business

One important part of the record-keeping process is the Business Number (BN). The BN is one of the federal government's initiatives to simplify the way businesses deal with the government.

The BN is a numbering system that simplifies and streamlines the way businesses deal with us. It is based on the idea of "one business, one number." This helps businesses reduce costs and be more competitive.

You get your BN the first time you register to do any business with us. Eventually, businesses will be able to use their BNs for other government programs.

The BN consists of two parts: the registration number and the account identifier.

The four major Canada Revenue Agency (CRA) business accounts and the **account identifiers** are as follows:

- **RC** – corporate income tax
- **RM** – import/export
- **RP** – payroll deductions
- **RT** – GST/HST

The number has 15 digits:

- 9 numbers to identify the business; and
- 2 letters and 4 numbers will identify each account.

For example, your BN might look like this:

1 2 3 4 5 6 7 8 9	**R P 0 0 0 2**
(Registration number)	(Account identifier)

Businesses that register for the BN will get one-stop business services, including integrated registration for new businesses, a consolidated approach to updating account information, and integrated business account enquiries.

Your BN and all related information are confidential.

If any information about your business changes, such as the address or telephone number, we will update the BN system, whether the change applies to one or several accounts.

Other accounts:

- **RR** – registered charity
- **RD** – excise duty
- **RE** – excise tax
- **RN** – insurance premium tax
- **RG** – air travellers security charge

Are you doing business in Quebec?

For businesses in Quebec, the BN does not include GST/HST accounts. Revenu Québec administers GST/HST on our behalf. If you plan to register for GST/HST in Quebec, please contact Revenu Québec at this address:

Revenu Québec
3800 de Marly Street
Ste-Foy QC G1X 4A5

Telephone: **1-800-567-4692**
Outside Canada: **(418) 659-4692**

4. Keeping records

Reasons why keeping records can benefit you

1. Good records can help you identify the sources of your income.

You may receive cash or property from many different places. If you don't have records showing your income sources, you may not be able to prove that some sources are non-business or non-taxable.

2. Well-kept records can mean tax savings.

Good records serve as a reminder of deductible expenses and input tax credits. If you don't record your transactions, you may forget some of your expenses or input tax credits when you prepare your income tax or GST/HST returns.

3. Well-kept records can prevent most of the problems you might encounter if we audit your income tax or GST/HST returns.

If your records are so incomplete that auditors cannot determine your income from them, the auditors will have to use other methods to establish your income. This will cost you time. If your records do not support your claims, they could be disallowed.

4. Your records will keep you better informed about the financial position of your business.

You need good records to establish your profit or loss, and the value of your business. Information from good records can also tell you what is happening in your business and why. The successful use of records can show you trends in your business, let you compare performance in different years, and help you prepare budgets and forecasts.

5. Proper records may help you get loans from banks and other creditors.

Creditors need accurate information about your current financial position before they give you a loan. You can't give them this information if you don't keep organized records. Also, good records show potential creditors that you know what's going on with your business.

Legal requirements for keeping records

All records such as paper documents, as well as those stored in an electronic medium (e.g., on computer disk), must be kept in Canada or made available in Canada at our request. You can keep these documents outside Canada if you get written permission from us.

What records should you keep?

Make sure you keep orderly records of all income you receive. Also, keep all receipts, invoices, vouchers, and cancelled cheques indicating outlays of money. Such outlays include:

- salaries and wages;
- operating expenses such as rent, advertising, and capital expenditures; and
- miscellaneous items, such as charitable donations.

You should keep these records at your place of business or residence in Canada (unless you get written permission from us to keep them elsewhere). You have to make them available to us on request.

Your records must be permanent

Whichever accounting or record-keeping method you use, your records must be permanent. They must contain a systematic account of your income, deductions, credits, and other information you need to report on your income tax and GST/HST returns.

What information should your records contain?

It's not hard to keep records that meet the requirements of the law. However, sketchy or incomplete records that use approximate (instead of exact) amounts are not acceptable.

Your records must:

- allow you to determine how much tax you owe, or the tax, duties, or other amounts to be collected, withheld, or deducted, or any refund or rebate you may claim; and
- be supported by vouchers or other necessary source documents. If you do not keep your receipts or other vouchers to support your expenses or claims, and there is no other evidence available, we may reduce the expenses or claims you have made.

5. Retaining and destroying records

The six-year requirement

You must retain books and records (other than certain documents for which there are special rules) for six years from the end of the last tax year to which they relate for income tax, or for six years from the end of the year to which they relate for GST/HST purposes.

If you filed your income tax return late, keep your records and supporting documents for six years from the date you filed the late return.

The minimum period for keeping books and records is usually measured from the last year you used the records, not the year the transaction occurred or the record was created. For example, let's say you bought some restaurant equipment in 2004 and sold it in 2006. In this case, even though the records relating to the purchase of the equipment were created in 2004, you need them to calculate the gain or loss on the sale in 2006. Therefore, you must keep the records until 2012.

You have to keep every book and supporting record necessary for dealing with an objection or appeal until it is resolved and the time for filing any further appeal has expired, or until the six-year period mentioned above has expired, whichever is the later.

Request for early destruction

If you want to destroy your books or records before the six years are up, you must apply in writing to the director of the tax services office in your area for permission from the Minister of National Revenue. To do this, either use Form T137, *Request for Destruction of Books and Records*, or prepare your own written request.

In addition to our requirements, there are other federal, provincial, and municipal laws that require you to keep books and records. We have no authority to approve destruction of books and records that these other laws require you to keep.

For more information on keeping books and records for income tax purposes, see Information Circular 78-10, *Books and Records Retention/Destruction*. For GST/HST, refer to Chapter 15, "Books and Records," of the GST/HST Memoranda series.

6. Accounting methods

Generally, you have to report business income (other than farming or fishing income) using the accrual method of accounting. Farmers or fishers can use the cash method or the accrual method, but not a combination of the two.

Accrual method

Under the accrual method, you have to report income in the fiscal year you earn it, regardless of when you receive payment. For example, if you have a December 31 fiscal year-end and you sell an item on credit on December 15, you have to include the sale in your income for that year even if you don't receive payment until January of the following year.

Similarly, you deduct allowable expenses in the fiscal period in which you incur them, whether or not you pay for them in that period. Generally, you are considered to incur an expense when you receive goods or services.

However, you have to claim the cost of goods purchased or produced for sale in the year you sell the goods. Assume, for example, that you bought 100 bicycles that you planned to resell at a profit. During the year, you actually sold 50 of the bicycles. You can, therefore, only claim the cost of purchasing 50 bicycles. You have to claim the balance of the purchase cost in the year that you sell the bicycles.

You have to claim prepaid costs as an expense in the year(s) during which you received the related benefit. Assume, for example, that in the middle of your fiscal period you prepaid one full year's rent ($6,000) on your business premises. You can only claim half of the rent ($3,000) in the year you paid it. You would claim the remaining $3,000 the following year. You can also claim a full input tax credit for GST/HST you paid on business rent.

Cash method

When you calculate income from a farming or fishing business, you may choose the cash method. To do so, simply file a return reporting your income from your farming or fishing business using the cash method.

Under this method, income includes all items of revenue you actually received during the year, whether in cash, property, or services. For example, if you sell an item on December 15 and don't receive payment until January 15, report the sale as income on January 15. Similarly, deduct your expenses in the year in which you actually pay them, except prepaid expenses.

When calculating your income using the cash method, you should not usually take inventories into account. However, if you have a net loss and you have purchased inventory on hand, you have to make the mandatory inventory adjustment to reduce your cash-basis loss. If you do not have a loss, you may choose to include all inventories by using the optional inventory adjustment.

A partnership in a farming or a fishing business can use the cash method only if all partners elect to use this method.

For more information about the cash method, get the guides T4003, *Farming Income* and T4004, *Fishing Income*.

Changing your method

If you are in a farming or fishing business, you can change from the accrual method to the cash method. To do so, file a return using the cash method and include a statement that properly reflects the changeover adjustments to both income and expenses.

However, if you would like to do the reverse and change from the cash method to the accrual method, you have to get permission from us. Send your request, along with the reasons for the change, to the director of your tax services office. You have to make this request before the date you are required to file your return for the year in which the change will take place.

Special accounting methods

There are also some special accounting methods that we accept for certain types of businesses. The following sections outline some of these methods.

Contractors – Generally, contractors have to include the amount of a progress billing, less any holdbacks in their income, when the purchaser approves the progress bill for payment.

For more information on this method, get Interpretation Bulletin IT-92, *Income of Contractors*.

Professional practice – Income from a professional practice is considered business income, and professionals have to report it using the accrual method. However, certain professionals may elect to use the modified accrual method. This method allows them to exclude their work in progress from the calculation of their income.

For more information, get the guide T4002, *Business and Professional Income*.

Special reserves – The *Income Tax Act* allows special reserves for certain types of businesses that use the accrual method. For example, if you are engaged in selling property, you may qualify for a reserve for part of the profit from a sale if you are receiving amounts on a deferred-payment basis.

Commission sales – If you are a self-employed commission sales agent, you can use the cash method to report your income and expenses as long as it accurately reflects your income for the year. Insurance agents and brokers can also set up special reserves.

For more information, get Interpretation Bulletins IT-154, *Special Reserves* and IT-152, *Special Reserves – Sale of Land*.

Sales journal and expense journal

We do not issue record books, nor do we recommend any particular book or set of books. There are, however, many adequate record books and record-keeping systems available that you can use.

The minimum requirement is a day-to-day record of your income and expenses. A book with columns and separate pages for income and expenses is most convenient. Keep this record, along with your duplicate deposit slips, bank statements, cancelled cheques, and receipts that support your expenditures. The following is an example of this type of book. You can change the headings to suit your business.

Notes
Do not send your records with your income tax return. However, keep them in case we ask to see them later.

If you do not keep the necessary information and you do not have any other proof, we may have to determine your income using other methods. We may also reduce the expenses you deducted.

Example
Assume that you are a sole proprietor operating a variety store. You record your cash sales on a cash register and write out sales invoices for sales on account.

On June 1, you examine the sales invoices and cash register tapes. You find that you had cash sales of $146 and sales on account of $27. In the sales journal, you record the cash sales in column 1 and the credit sales in column 2. Since there were no merchandise returns on June 1, leave column 3 blank.

Column 4 then shows the total of your cash sales plus credit sales minus any merchandise returned for the day. In columns 5 and 6, show the total of GST/HST and PST you charged on your sales.

In column 7, keep track of any cash received on previous credit sales. Don't include this amount in the daily sales figure, since you would have included it in the sales figure on the day the sale took place.

Once you have made the appropriate entries in the sales journal for the day, verify that you are making the proper entries elsewhere. Add the sales on account for the day to the proper account cards.

Credit the sums that the customers paid in the course of the day, in payment of their account. You should file copies of your sales invoices together, in proper order, so that you can easily review any one of the invoices later. If you have cash register tapes, total them at the end of the day.

Keep them in an orderly manner for future reference. You can total each column at the end of the month, and start a new page for the next month. Column 4 will tell you your total sales for the month.

The other columns simply provide a summary of how you arrived at, among other things, your total sales, payments on account, and GST/HST collected. You can alter the format of the sales journal to suit your own business.

For example, if you are a farmer, you may have 20 large sales in a year, instead of many small sales each day. In this case, you may decide to record your income as you make each sale, instead of recording daily totals throughout the year.

Or perhaps you own a clothing store. You may find it more useful to maintain a separate column, or even a separate sales journal, for the men's, ladies', and children's wear. This would also be acceptable, provided the records are easy to follow and you can support them with the proper documentation.

Sales journal – Month of June

	Date	Particulars	Cash sales (1)*	Credit sales (2)*	Sales returns (3)*	Total sales (4)*	GST/HST (7%)/(15%) (5)**	PST (7%) (6)	Payment on account (7)
1	June 1	Daily sales	146.00	27.00		173.00	12.11	12.11	10.00
2	June 2	Daily sales	167.00	36.25	26.00	177.25	12.41	12.41	
3	June 3	Daily sales	155.02	19.95	10.00	164.96	11.55	11.55	32.40
4	June 4	Daily sales	147.00	29.95		176.95	12.39	12.39	

* Does not include GST/HST or PST.

** If you sell to a resident in one of the participating provinces, HST at 15 % replaces GST and PST. For more information on HST, see the guide RC4022, *General Information for GST/HST Registrants*.

Business expense journal

You can generally deduct business expenses if you incur them for the sole purpose of producing income. Expenses claimed have to be supported by all your business-related vouchers and receipts, and by recording all your expenses in a journal.

The simplest method of recording these expenses is a basic sheet with columns, as shown in the example. You can modify the headings to suit your type of business. At the end of each month, total each column, and then start a new sheet for the next month. This is a very simple bookkeeping system that meets our requirements.

Example

On June 1, you paid XYZ Radio for some advertising. In the expense journal, you record the date, June 1, in the first column. In the next column, record who you paid the cheque to (XYZ Radio). The third column is where you record the cheque number (407). Finally, decide what the payment was for (e.g., GST/HST, advertising), and record the amount of the cheque in the appropriate column.

The next step is to write, on the bill that you received for the advertising, the cheque number (407) and the date you paid it. File this bill in your advertising expense file, which can be a simple folder containing all of your advertising bills for the year. File the bills chronologically, so that you can easily review them as you go through your expense journal.

Treat the rest of the payments in our example the similar way. Under the appropriate column, record the date, the payee, the cheque number, and the amount of the expense.

You must also remember to keep your cancelled cheques once you receive them from the bank. This is part of your proof that you paid the bill or bought the asset. As with the sales invoices and the bills, you have to keep the cancelled cheques in an orderly manner so you can easily refer to them later on.

Expense journal – Month of June

Date	Particulars	Cheque No.	Bank	GST/ HST*	Purchases	Legal acc't	Adv.	Fees	Repairs	Capital items
June 1	XYZ Radio	407	374.50	24.50			350.00			
June 1	Smith Hardware	408	27.47	1.80					25.67	
June 2	City of Ottawa	409	160.50	10.50				150.00		
June 3	Andy's Accounting	410	267.50	17.50		250.00				
June 5	Wholesale Supply	411	1871.58	122.44	1749.14					
June 5	Ed's Used Cars	412	1605.00	105.00						1500.00

* If you reside in one of the participating provinces, HST at 15% replaces GST and PST. For more information on HST, see the guide RC4022, *General Information for GST/HST Registrants*.

7. Fiscal periods

You have to report your business income once a year for sole proprietorships, professional corporations that are members of a partnership, and partnerships in which at least one member of the partnership is an individual, professional corporation, or another affected partnership.

If you are a sole proprietorship or in a partnership, which all the members are individuals, you can elect to have a non-calendar year fiscal period. To file your election, use Form T1139, *Reconciliation of Business Income for Tax Purposes.* For more information, see the guide RC4015, *Reconciliation of Business Income for Tax Purposes*.

A corporation can choose a fiscal period that ends on any date. The corporation has to file its income tax return within six months of the end of its fiscal period.

The rules governing fiscal periods are complex. It's a good idea to get familiar with them before you get into business. For more information, see our guide T4002, *Business and Professional Income*.

Note
If you are a goods and services tax (GST) or harmonized sales tax (HST) registrant, your decision about your fiscal period end for income tax purposes may affect your GST/HST reporting periods, as well as your filing and balance due dates.

For more information, visit our Web site at **www.cra.gc.ca** or call our Business Enquiries line at **1-800-959-5525**.

Filing due date and balance due day

If you have self-employment income, or if you are the spouse of someone who does, you have until June 15 of the year following the taxation year to file your return and Form T1139, *Reconciliation of Business Income for Tax Purposes*, unless the expenditures made in the course of carrying on the business are primarily the cost or capital cost of tax shelters. However, you have to pay any tax balance owing by April 30 of the year following the taxation year.

Part 2 – Rights and Obligations

This part gives you information on the self-assessment system and how we administer it. The topics covered include self-assessment, paying taxes, filing dates, audit procedures, the appeals process, fairness legislation, and the income tax return.

1. Self-assessment

Compliance

Our tax system in Canada is based on the principle of self-assessment. It means that all residents of Canada and all non-residents with income earned in Canada are responsible for paying their duty and tax according to the law.

Administering the federal tax system fairly and efficiently depends on two things:

- We have to interpret and apply the law consistently and fairly.
- Clients have to make honest self-assessments of the duty and tax they have to pay.

To make the system more efficient and easier to enforce, we require that clients fulfil certain obligations. Clients include importers (or brokers) and exporters, employers, people paying interest or dividends, and people making payments to others who are not Canadian residents. These people have to report payments, and withhold and remit duty and tax to us.

We have a comprehensive audit program that verifies compliance and maintains public confidence in the integrity of the tax system. Clients are selected for audit on the basis of risk indicators, sampling results, and compliance records. A poor compliance record increases a client's chance of being selected for later audits.

The audit program is directed mainly at clients who have sources of income other than a regular salary. This includes self-employed individuals such as professionals, business people, farmers, and people who receive income from investments, rentals, and commissions. The program also covers trusts and corporate clients, with the largest corporations being subject to more frequent audits.

The personal contact afforded by an audit is an ideal vehicle for promoting an atmosphere in which clients can realize that each is bearing a lawful share of the tax burden, and not more than that share.

Disclosure

It is our policy that any person who has failed to file a required return or who has filed an incorrect return, and who later makes a voluntary disclosure about these matters, will be permitted to settle any tax liabilities (plus interest and late-filing penalties). Since a corporation is considered a person under the *Income Tax Act*, this policy applies to corporations as well as individuals.

We will not prosecute these persons or attempt to apply any civil penalties for gross negligence or tax evasion. We will also hold in confidence the identity of anyone making a voluntary disclosure. This policy applies to everyone who meets the following requirements:

- The client must initiate a voluntary disclosure, since this shows a sincere desire to correct previous errors or omissions. We will not consider as voluntary a disclosure that results from an audit or other action taken by us.
- Each voluntary disclosure should include enough details to enable us to verify the facts.
- The client has to pay the entire tax liability, or else make mutually agreeable arrangements to repay all amounts due in instalments.

- If we determine that the voluntary disclosure was not complete because the client disclosed only the information that the client thought we would become aware of or would accept as complete, we will not consider the disclosure as voluntary. The client may still be subject to a penalty or prosecution, if circumstances warrant.

Clients can make a voluntary disclosure by contacting a senior official at the nearest Canada Revenue Agency (CRA) office. We will not require a detailed submission at first contact, but will require one within a period of time we mutually agree on. We consider the initial contact to be the date of the voluntary disclosure.

2. Paying taxes

Payroll deductions

If you are an employer, you are responsible for deducting from your employees' pay cheques the amounts relating to income tax, Canada Pension Plan (CPP), and Employment Insurance.

As an employer, you are holding these deductions in trust for your employees. Therefore, you are expected to keep these funds separate from the operating funds of your business.

If you do not withhold these amounts, or do not remit them to us when required, you will be subject to certain penalties.

You may be eligible to remit your payroll deductions electronically. For more information visit our Web site at **http://www.cra.gc.ca/tax/business/topics/payroll/payments/howtopay-e.html**.

Instalments

Employees generally have income tax deducted from their pay cheque on a weekly or monthly basis. However, if you are self-employed, you do not have tax deducted from your income.

As a sole proprietor, partner, or corporation, you may be required to pay your income tax in instalments throughout the year. If you have to pay tax by instalments, we will send you a notice telling you how much to pay.

To find out more about paying tax by instalments, get the brochure P110, *Paying Your Income Tax by Instalments*. You may have to pay a penalty and interest if you do not pay your instalments on time, or if you do not pay the full instalment amount you owe.

For more information, visit our Web site at **www.cra.gc.ca/instalments** or contact our **1-800-959-5525**.

3. Summary of filing dates (Important Dates for Income Tax)

Sole proprietorships and partnerships	
Monthly by the 15th	Remit the payroll deductions from your employees' pay cheques, along with your part of Canada Pension Plan (CPP) contributions and Employment Insurance (EI) premiums, by the 15th of the following month.
Last day of February	File your T4 and T4A slips, with us along with the related summary. Distribute the slips to your employees.
March 15	If you are self-employed, make your **first instalment** payment of tax and CPP contributions.
March 31	Partnerships (except those made up of corporations, or a combination of individuals, corporations, or trusts for which the filing date can be different) must file a partnership information return.
April 30	File your T1 personal income tax and benefit return for the previous year. **Pay** any tax amounts owing. Self-employed individuals and their spouses or common-law partners have until June 15 to **file** their returns.
June 15	Make your **second instalment** payment. Generally, self-employed individuals (and their spouses or common-law partners) must file their T1 and benefit returns. You have to pay any balance owing **by April 30** to avoid interest charges).
September 15	If you are self-employed, make your **third instalment** payment of tax and CPP contributions.
December 15	If you are self-employed, make your **fourth instalment** payment of tax and CPP contributions.
December 31	For farmers and fishers, calculate and pay the amount of your current-year instalment payment.
Corporations	
Last day of February	File with us your T4 and T4A slips along with the related summary form. Distribute the slips to your employees.
Monthly	Remit the payroll deductions from your employees' pay cheques by the fifteenth of the following month. Include your portion of CPP contributions and EI premiums.
Monthly	Corporations have to pay instalments of their current-year taxes by the last day of each month.
Two months from your taxation year-end	The balance of the corporation tax payable is due.
Three months from your taxation year-end	The balance of the corporation tax payable is due for certain Canadian controlled private corporation. For more information see the guide *T2 – Corporation Income Tax Return*.
Six months from your taxation year-end	Corporations must file a *T2 Corporate Income Tax Return* no later than six months after the corporation's year-end.

Note
It is important that you file any required returns and remit payments on time. Penalties apply if you don't, and interest is charged on unpaid taxes and penalties.

4. Audits

What is an audit?

The primary purpose of an audit is to monitor and maintain the self-assessment system. Although there is a high standard of public compliance with the law in Canada, we can only maintain a self-assessment system by continuously inspecting GST/HST and income tax returns, and payroll records. As a result, an audit plays an important role in achieving our objectives to:

- collect the taxes imposed by encouraging voluntary compliance; and
- maintain public confidence in the integrity of the tax system.

How we select files to audit

All returns are recorded on a computer system that enables us to select returns to be audited. The system also allows us to sort returns into various groups to help with our selection.

In some cases, we choose specific returns from computer-generated lists. In some cases, we compare selected financial information for current and previous years of clients engaged in similar businesses or occupations.

There are no rigid rules for the person screening the files at each office to follow, other than to be objective and impartial.

Most returns are selected in this way. But there are three other common ways of selecting files to audit:

- **Audit projects** – In some cases, we test the compliance of a particular group of clients. If the test results indicate that there is significant non-compliance within the group, we may audit its members on a local, regional, or national basis.
- **Leads** – Information from other audits or investigations, or from outside sources including informers, may lead to the selection of a particular file for audit.
- **Secondary files** – Sometimes we select a file for audit because of its association with another file previously selected. For example, if you are in partnership with another client, and that person's file has been selected for audit, it is usually more convenient to examine all the records at the same time. In addition, the affairs of such clients are often so interwoven that the auditor has to examine them together.

How we conduct an audit

Before beginning an audit, an auditor will contact you to arrange a convenient date to start. The auditor will then begin to review your file.

In this preliminary review, the auditor examines:

- the return documents selected for audit
- the attached financial statements
- the audit reports from previous audits if any; and
- any other information in the file.

In doing so, the auditor can plan how to approach the audit.

On arriving at your place of business, the auditor will present an identification card. Before examining your books and records, the auditor may want to discuss the general nature of the business or tour the premises to gain a better understanding of the transactions recorded in your books. Your co-operation permits a faster and more efficient audit and is therefore of mutual benefit.

The auditor determines the scope of the audit with the advice and direction of a supervisor. They decide which records to examine and what audit techniques to use. The audit usually includes an examination of your ledgers, journals, bank accounts, sales invoices, purchase vouchers, and expense accounts. Throughout the process, the auditor may need to get information and assistance from your employees, particularly those who do your accounting.

The auditor does not usually question items one by one as the examination proceeds. Periodically, however, the auditor may present you with a group of questions to which he or she is not able to find answers.

How to avoid delays in the audit

Although the actual audit time may only be one or two weeks, the elapsed time from start to finish may be longer. Unavoidable delays may occur when you want to consult with advisors, or are called out of town before the audit is completed. Similarly, the auditor may ask for an interpretation from CRA Headquarters on a particularly complex or contentious point of law.

Sometimes, however, clients or their representatives cause unnecessary delays by failing to provide information or documents as requested. When this happens, the auditor can get information by:

- providing a written request to the client or the client's representative (the auditor will allow a reasonable period of time to produce the information)
- formally requiring it under the law (a conviction for failing to comply could result in a fine)
- reassessing the return based on the incomplete information available. To dispute the reassessment, the client might then have to produce the missing information. We use this somewhat arbitrary method in moderation. Clients can usually avoid problems if they advise the auditor of any valid reason for a delay in providing the requested information.

Reassessments

When an audit is completed, the auditor may propose certain adjustments to your return. The auditor will prepare a summary of the proposed adjustments.

Initially, the auditor will discuss the proposal with you or your representative. If you request it, or if it is reasonable to expect that you will need some time to analyze the proposed adjustments, the auditor will confirm the proposal in writing and allow a reasonable time for your reply.

If you provide more information within this interval, the auditor will take it into consideration and, if applicable, issue a new proposal letter. If there are no proposed adjustments to your return, you will be informed of this when the audit is completed.

Once the audit is finalized, you will be issued a *Notice of Assessment* or *Notice of Reassessment*.

> **Note**
> The auditor's role is to determine the correct amount of tax payable. If this results in less tax owing, you may get a refund as a result.

5. Appeals

Under income tax legislation, you are entitled to object to an assessment or reassessment if you think that the law has been applied incorrectly. The procedures for GST/HST and income tax situations are similar.

Objection process

If you disagree with your *Notice of Assessment* or *Notice of Reassessment*, you can file an objection. To do this, visit our Web site at **www.cra.gc.ca/resolvingdisputes** or write to the Chief of Appeals at your tax services office, or using the Form T400A, *Objection*.

File your letter or form **no later than**:

- one year after the due date of the return; or
- 90 days after the date we mailed your *Notice of Assessment* or *Notice of Reassessment*.

When we get your letter or form, we will reconsider the assessment and then either confirm or change it. If we do not allow your appeal, we will send you a formal notice by registered mail. You can then appeal the decision to the Tax Court of Canada within 90 days.

You do not have to pay the tax you are disputing while you are waiting for the CRA or a court to settle your appeal. However, these taxes are still subject to the usual interest charges. Before you appeal a lower court's decision to a higher court, you have to pay the tax in dispute or post acceptable security.

Appeals process

Tax Court of Canada

If you disagree with our decision on the objection, you can file a notice of appeal to the Tax Court of Canada within 90 days of the day the decision is issued. You may also file a notice of appeal with this court if you have not received a reply from us within 90 days of filing your objection.

The Tax Court of Canada deals with appeals under the informal or general procedure.

Informal procedure

This procedure is designed to resolve less complex cases involving smaller amounts of taxes, interest, and penalties. You have to indicate in your appeal that you want the Court to hear your case under this procedure.

Through a series of strict time frames built into this procedure, decisions should be made within about six months of the date you filed your appeal.

Decisions are final and not subject to appeal. However, they are subject to judicial review by the Federal Court of Appeal.

General procedure

If you do not elect to have your appeal heard under the informal procedure, it will be heard under the general procedure. This is a more formal process that includes:

- filing a written notice of appeal
- paying a filing fee
- restricting representation in court to either you or your lawyer
- awarding costs to either party.

The Federal Court of Appeal reviews appeals by either party of decisions made under this procedure.

Federal Court of Appeal

If either you or the Minister want to appeal a decision the Tax Court of Canada made under the general procedure, the appeal must be filed with the Federal Court of Appeal no later than 30 days after the decision.

Either party can request that the Federal Court of Appeal review a decision the Tax Court of Canada made under the informal procedure. The Federal Court review will be restricted to questions of law and jurisdiction. An application for this type of review has to be filed no later than 30 days after the decision of the Tax Court of Canada.

Supreme Court of Canada

You can appeal a judgment of the Federal Court of Appeal to the Supreme Court of Canada. However, you first have to get the Supreme Court's permission.

6. Fairness provision

The *Income Tax Act and the Excise Tax Act* contain fairness provisions that help us administer the legislative requirements of these Acts fairly.

This applies to refunds of tax overpaid through payroll deductions. Refunds are also possible for taxpayers who discover that they missed a deduction or non-refundable tax credit when they previously filed a return.

Under the fairness provisions we can also waive or cancel interest or penalties when they result from factors that are beyond a taxpayer's control, such as when a taxpayer is prevented by illness from filing a tax return by the April 30 deadline.

For detailed information visit our Web site at **www.cra.gc.ca/fairness** or call our **1-800-959-5525**.

7. Income tax return

Sole proprietorship

If you are the sole proprietor of your business, you have to file a return if you:

- owe tax for the year
- disposed of capital property or had a capital gain in the year
- are required to make CPP payments on self-employed earnings or pensionable earnings for the year
- received a demand from us to file a return.

If none of the above circumstances apply to you, you do not have to file a return. However, if you are claiming an income tax refund, a refundable Tax Credits, a GST/HST credit, or the Canada Child Tax Benefit, you do need to file a return. You may also be entitled to receive provincial tax credits.

As a sole proprietor, your return has to include financial statements or one or more of the following forms:

- T2124, *Statement of Business Activities*
- T2032, *Statement of Professional Activities*
- T2042, *Statement of Farming Activities*
- T2121, *Statement of Fishing Activities*
- T1163, *Statement A – CAIS Account Information and Statement of Farming Activities for Individuals*
- T1164, *Statement B – CAIS Account Information and Statement of Farming Activities for Additional Farming Operations*.

A computer-generated version of the applicable form is acceptable. Remember to include other types of income, such as employment income and rental income, on your income tax return.

Partnerships

A partnership does not pay income tax on its operating results and does not have to file an annual income tax return. Instead, each partner has to file financial statements, one of the forms indicated above, or a computer-generated version of the form. This is the case whether or not the partner actually received the allocation in money or in credit to a partnership capital account.

Corporations

All corporations, whether taxable or non-taxable, have to file corporate income tax returns. Each corporate income tax return has to include financial statements and other schedules that apply. The corporation has to file the return no later than six months after the end of the corporation's taxation year.

When the fiscal year ends on the last day of the month, the return is due on or before the last day of the sixth following month. When the fiscal year ends on a day other than the last day of the month, the return is due on or before the same day of the sixth following month.

Most corporations' Income Tax Returns can be filed electronically on the Internet.

For more information, visit our Web site at **www.cra.gc.ca/eservices/corpnet** or call our **1-800-959-5525**.

Part 3 – Income and Expenses

This part gives you an overview of the business income and expenses that you should account for in your records for income tax purposes.

1. Income and expenses

Business income

Business income includes income from:

- a profession
- a calling
- a trade
- a manufacture or undertaking of any kind; and
- an adventure or concern in the nature of trade.

It also includes income from any activity you do for profit. For example, income from a service business is business income. However, you **do not** include employment income as business income.

> **Note**
> You have to report all amounts of income that are required for calculating income for tax purposes. If you repeatedly fail to report all your income, you may be subject to a penalty of 10% of the amount of income that you failed to report.

Records of account

Self-employed individuals have to provide information about their business income and expenses. Although we accept other types of financial statements, we encourage you to use the following forms:

- T2124, *Statement of Business Activities*
- T2032, *Statement of Professional Activities*
- T2042, *Statement of Farming Activities*
- T2121, *Statement of Fishing Activities*
- T1163, *Statement A – CAIS Account Information and Statement of Farming Activities for Individuals*
- T1164, *Statement B – CAIS Account Information and Statement of Farming Activities for Additional Farming Operations*.

While they are not meant to be standard financial statements, the forms include optional balancing fields so that they can be used as financial statements if desired. You can find instructions on how to complete the forms on our Web site at **www.cra.gc.ca** or in the applicable tax guides.

We have designed these forms to accommodate the most common types of income and expense categories used in business. They should not pose any problems for you in setting up your records of account.

Your records should contain the dates and amounts of any income you received or earned, regardless of its source, and whether you received it in cash, property, or services.

You must also record as income any amount credited to your account or set aside for you as payment for providing goods and services. This also includes amounts credited to your account as offsets against an amount you owe.

For example, you sell merchandise to a dealer, and instead of the dealer paying you cash, you allow him to give you a credit to apply against a future purchase. You have to include this amount in income, even though you didn't actually receive the funds.

You have to support all income entries in your records with original documents such as sales invoices, cash register tapes, receipts, patient cards, fee statements, and contracts, depending on the type of business you are in. Keep the supporting documents in chronological or numerical order and make them available if we ask to see them.

You should also keep a separate record of your income from all other sources, such as professional fees, income from property, investments, taxable capital gains, estates, trusts, employment, and pensions.

Business expenses

You can generally deduct business expenses if you incur them for the sole purpose of earning income. For more detailed information, see the section called "Operating expenses" later in this module. Purchases and business expenses must also be substantiated with a sales invoice, agreement of purchase and sale, a receipt, or some other voucher that supports the expenditure.

Remember to keep your cancelled cheques if you receive them from the bank. This is part of your proof that the bill was paid or the asset purchased. Keep the cancelled cheques in an orderly manner so we can easily review them.

Personal or living expenses

No deduction is allowed for personal and living expenses, except for travelling expenses you incur while away from home in the course of carrying on a business. In most cases, personal and living expenses are not deductible because of a provision in the *Income Tax Act*.

The provision states that an outlay or expense may not be deducted except to the extent that it was made or incurred for the purpose of gaining or producing income from property or business.

Input tax credit

A fundamental principle of GST/HST is that no tax should be incorporated into the cost of inputs that registrants use in commercial activities. With certain exceptions, registrants are entitled to a refundable credit, called an input tax credit, for tax paid or payable on purchases that relate to a commercial activity.

As a GST/HST registrant, you can get back the GST/HST you paid or that you owe on purchases and expenses related to your commercial activities. You do this by claiming an input tax credit.

You can recover the GST/HST you pay or owe on goods and services such as:

- merchandise to resell
- advertising services
- real property and capital property, such as office furniture, vehicles, and other equipment
- general operating expenses such as office rent, utilities, office supplies, and the rent of equipment such as computers, vehicles, photocopy machines, and other office appliances.

Where goods or services are used partly for personal use or for making exempt supplies, you are entitled to a partial input tax credit to the extent that the goods or services are for use in commercial activities.

In addition, you can claim input tax credits for purchases of land and purchases eligible for capital cost allowance under the *Income Tax Act*, such as buildings, computers, vehicles, and other large machinery and equipment.

Expenses for which you cannot claim an input tax credit include the following:

- employee wages
- interest and dividend payments
- most federal, provincial, and municipal taxes
- most fees, fines, and levies
- tax-exempt goods and services
- items for your personal use or enjoyment
- capital property that is not primarily for use in your commercial activities
- membership fees or dues to any club that provides recreational, dining, or sporting facilities (e.g., fitness clubs, golf clubs, hunting and fishing clubs), unless you acquire the memberships to resell in the course of your business.

2. Types of income

During the year, you may receive income from your business and from sources other than your actual sales. If they relate to your business, you have to include them in income. You may also have to include items in income in the current year because of the treatment that they received in past years. You should list any miscellaneous sources of income separately on your income statement. The following example shows you how to do the calculation.

Example

Sales		$500,000
Add: Reserves allowed in prior year		65,000
		$565,000
Less: Returns and allowances	$36,750	
Sales tax (included in sales)	25,000	61,750
		$503,250
Other income		
Bad debts previously written off	17,495	
Hawaii trip from supplier	3,500	20,995
Gross income		**$524,245**

The following sections outline some of the more common examples of other income.

Bad debts

If, during the year, you received any amount that was written off as a bad debt in a previous year, you have to include the amount in your income for the current year. There may be GST/HST implications on the recovery of bad debts. For more information, see the guide RC4022, *General Information for GST/HST Registrants*.

Reserves

You have to bring any reserve you claimed in a given year back into income in the following year. The *Income Tax Act* allows you to take a new reserve based on your circumstances at that time. For more information, see IT 154, *Special reserves.*

Vacation trips and awards

If you have received vacation trips or other awards of any kind (e.g., jewellery or furniture) as a result of your business activities, you have to include the value of these awards in your business income. There may be GST/HST implications on vacation trips and awards. For more information, see the guide RC4022, *General Information for GST/HST Registrants*.

Government grants and subsidies

You may receive a grant from a government or government agency that:

- increases your income or reduces your expenses
- relates to an income deficiency
- relates to specific expenses.

If this is the case, you must either add the grant to your income or deduct it from the specific expenses. For example, if you are a farmer and you received a payment to subsidize your income in a drought year, you would add the payment to income. On the other hand, if you are a manufacturer, and you received a government employment grant to allow you to hire more students, you would generally deduct it from the wage expense you are claiming.

Government assistance that enables you to acquire capital property does not increase your net income. However, in the case of depreciable property, you reduce the capital cost of the property by the amount of the assistance received. In the case of other capital property, reduce the adjusted cost base accordingly. For more information, see Interpretation Bulletin IT-273, *Government Assistance – General Comments.*

Surface rentals for petroleum or natural gas exploration

If you have land that you usually use in your farming or business operation, and you are leasing it out for petroleum or natural gas exploration, you may have to include an amount in your income either as a capital receipt or as an income receipt. For detailed information, see Interpretation Bulletin IT-200, *Surface Rentals and Farming Operations*.

Rental income

Do not include rental income, whether from farm property or real estate, with your business or farming income. You have to report it separately on your tax return.

To calculate your net rental income on your income tax return, use Form T776, *Statement of Real Estate Rentals*. Many of our publications are available on our Web site at **www.cra.gc.ca/formspubs**. You can also get copies of our guides and forms by calling us at **1-800-959-2221.**

Barter transactions

If you are involved in a barter transaction, you could be deemed to receive amounts as proceeds from a business operation.

A barter transaction takes place when any two persons agree to a reciprocal exchange of goods and services, and carry out that exchange without using money. If you are in a business or profession that provides services that are offered in a barter transaction in exchange for goods or services, you have to include the value of the services you provide in your income. There may be GST/HST implications on barter transactions.

For more information, see the guide RC4022, *General Information for GST/HST Registrants* on our Web site at **www.cra.gc.ca/barter/gsthst** or call us at **1-800-959-5525.**

Selling a property

If you sell a capital property, you may have to include certain amounts in your income, such as:

- a recovery of capital cost allowance, known as recapture; and
- part of any capital gain you realize on the sale.

Generally, you have a capital gain or a capital loss when you dispose of capital property. For example, if you sell a piece of land for more than it cost you, you have a capital gain as a result. Similarly, if you sell the land for less than it cost you, you have a capital loss.

The taxable capital gain or the allowable capital loss is generally equal to half of your actual capital gain or loss. If you taxable capital gains are **more** than your allowable capital losses, include the difference in your income.

If your taxable capital gains are **less** than your allowable capital losses, the difference is your net capital loss. You cannot use this loss to reduce your income from other sources. However, you can apply your net capital loss against taxable capital gains of other years.

For more information on capital gains and capital losses, see the guide T4037, *Capital Gains*. For special rules relating to farmers, see the guide T4003, *Farming Income*.

Also, there may be GST/HST implications when you sell a property. For more information, see the guide RC4022, *General Information for GST/HST Registrants*.

3. Inventory and cost of goods sold

To match costs with income, you need to prepare an annual inventory. This is usually a list of goods held for sale including (in the case of a manufacturer) raw materials, goods in process, and finished goods that you have on hand.

If your business is a profession, you determine its inventory in a similar way. However, if you have a professional practice and you are an accountant, dentist, lawyer, medical doctor, notary, veterinarian, or chiropractor, you may elect to exclude your work-in-progress when you determine inventory.

How to value your inventory

The value you place on the items in your year-end inventory is important in determining your income. For income tax purposes, the two acceptable methods of valuing your inventory are by determining:

- the value of your entire inventory at its fair market value (use either the price you would pay to replace an item, or the amount you would get if you sold an item);
- the value of individual items (or classes of items if specific items are not readily distinguishable) in the inventory at either their cost or their fair market value, whichever is lower.

Once you choose a method of inventory valuation, you must continue to use this method in subsequent years. For more information about valuing inventory, see Interpretation Bulletin IT-473, *Inventory Valuation,* and its Special Release.

4. Capital or current operating expenses

You cannot charge as a current operating business expense the cost of capital additions such as equipment and buildings used to earn income in a business. Although most expenses are deductible in the year you either incurred or paid them, you have to treat the purchase of this type of asset differently.

Since such properties will wear out over a number of years or become obsolete, you can make a yearly deduction for their cost for income tax purposes. This is called capital cost allowance (CCA) and is covered later in this module.

There may be circumstances when it is difficult to determine whether your expenditure is a **current operating expense** or a **capital addition**; for example, when major repairs or renovations are done to a building. The following guidelines will help you decide:

a) **Enduring benefit** – If your expenditure will have a long-term benefit to the business, you may consider it capital in nature. If, however, it is likely that you will have recurring expenditures for replacement or renewal of the item because of its short useful life, this may indicate that the expenditure is of a current nature.

b) **Maintenance or betterment** – If you made an expenditure only to restore a property to its original condition, this expenditure is probably of a current nature. If, however, the expenditure improves the property beyond its original condition, such as a new floor or roof that is clearly of better quality and greater durability than the old one, then the expenditure is considered capital in nature.

c) **Integral part or separate asset** – Expenditure to repair part of a property is probably a current operating expense, while an acquisition of a property that is a separate asset is probably a capital expenditure. For example, we regard the cost of replacing the rudder on a ship as a current operating expense because it is an integral part of the ship and there is no improvement. However, we regard the cost of replacing a lathe in a factory as a capital expenditure, because the lathe is not an integral part of the factory but is a separate marketable asset.

d) **Relative value** – You may have to consider the amount of the expenditure in relation to the value of the whole property. For example, although a spark plug in an engine may be a separate marketable asset, you would never regard the cost of replacing it as anything but a current operating expense. However, if you replaced the engine itself, the expenditure is not only for a separate marketable asset but it is also likely to be very substantial in relation to the total value of the property. If so, we would probably regard the expenditure as capital in nature.

e) **Acquisition of used property** – If you acquire used property that requires repairs or replacements to put it in suitable condition for use, we would regard the cost of such work as capital in nature even though, in other circumstances, we would treat it as a current operating expense.

f) **Anticipation of sale** – We consider repairs made to sell a property, or as a condition of the sale, to be capital in nature.

For more information about the differences between capital expenditures and current operating expenses, see Interpretation Bulletin IT-128, *Capital Cost Allowance – Depreciable Property*.

In your records, you can list your capital additions in columns; in the same way you record your expenses. The record should show from whom you acquired the asset, as well as the cost and date of the acquisition. For example:

Date	Asset	Cost	Details
June 4, 2004	GS-14 Lathe	$2,600	Martins Equipment, cheque 504
June 7, 2004	Forklift	$6,250	Smith Equipment, traded old forklift for $4,000, issued cheque 515 – $2,250

You have to then keep the purchase contract and the cancelled cheque or other method of payment so you can support the amount in your records. When you sell or trade an asset, show the date you disposed of it and the amount you received or were allowed on trade-in.

5. Capital cost allowance

You cannot claim as an operating expense the original cost of equipment and buildings, which you used to earn income. However, to recognize that over a number of years such properties will wear out or become obsolete, you can claim as a deduction a part of their cost each year. The deduction you can claim each year for income tax purposes is called capital cost allowance. It limits the amount written off each year as capital cost of the property.

Under the capital cost allowance system, the depreciable assets you purchase are grouped into classes established by the *Income Tax Regulations*. These regulations specify a rate of capital cost allowance for each class of property. If you have a number of properties within a particular class, we treat the properties of that class as one unit for the purposes of capital cost allowance.

The following chart lists some of the more common classes:

Capital cost allowance (CCA) classes

The following is a list of commonly used assets in a business.

Class	Rate (%)	Description
1	4	Most buildings you bought after 1987, including components such as wiring, plumbing, heating, and cooling systems.
3	5	Most buildings, including components that you bought after 1978 and before 1988. However, you may have to include part of the cost of additions made after 1987 in class 1. For more details, get Interpretation Bulletin IT-79, *Capital Cost Allowance – Buildings or Other Structures*.
6	10	Frame, log, stucco on frame, galvanized iron, or corrugated metal buildings that do not have any footings below the ground. Class 6 also includes fences and greenhouses.
7	15	Canoes, rowboats, and most other vessels and their motors, furniture, and fittings. For more information, get Interpretation Bulletin IT-267, *Capital Cost Allowance – Vessels*.
8	20	Property that you did not include in any other class. Some examples are fixtures, furniture, machinery, photocopiers, refrigeration equipment, telephones, and tools costing $200 or more. Class 8 also includes outdoor advertising signs you bought after 1987. Data network infrastructure equipment acquired after March 22, 2004 (usually included in class 8 at 20%) will be included in a new class 46 with a 30% CCA rate.
9	25	Aircraft, including furniture or equipment attached to the aircraft, and spare parts.
10	30	Automobiles except those you use as a taxi or in a daily rental business includes, vans, trucks, tractors, wagons, and trailers. General-purpose electronic data-processing equipment (commonly called computer hardware) and systems software. Computer equipment and systems software acquired after March 22, 2004 will be included in new class 45 and the CCA rate will increase from 30% to 45%. The current rule allowing a separate class election is not available for equipment that qualifies for the 45% rate. However, you may elect to have the current rule apply for equipment that is acquired before 2005.
10.1	30	A passenger vehicle. See chapter 4 for the capital cost limits in T4002, *Business and Professional Income* guide.
12	100	China, cutlery, kitchen utensils that cost you less than $200, linen, and uniforms. Include in class 12, dies, jigs, moulds, and cutting or shaping parts of a machine. Also put tools and medical or dental instruments that cost you less than $200 in class 12. Class 12 also includes computer software (except systems software), and videocassettes bought after February 15, 1984, that you rent and do not expect to rent to any one person for more than 7 days in a 30-day period.
13		Leasehold interest – You can claim CCA on a leasehold interest, but the maximum rate depends on the type of leasehold interest and the terms of the lease.
14		Patents, franchises, concessions, or licences for a limited period. Your CCA is one of the following two amounts, whichever is less: ■ the capital cost of the property spread out over the life of the property; or ■ the undepreciated capital cost (UCC) of the property of that class at the end of the taxation year.
16	40	Taxis and vehicles you use in a daily car-rental business. Class 16 also includes coin-operated video games and pinball machines acquired after February 15, 1984, and freight trucks acquired after December 6, 1991, that are rated higher than 11,788 kilograms.
17	8	Roads, parking lots, sidewalks, airplane runways, storage areas, or similar surface construction.
22	50	Most power-operated, movable equipment you bought before 1988 that you use for excavating, moving, placing, or compacting earth, rock, concrete, or asphalt.
38	30	Most power-operated, movable equipment you bought after 1987 and use for excavating, moving, placing, or compacting earth, rock, concrete, or asphalt.

Note
You can choose to keep an outdoor advertising sign and any property you would usually include in class 38. To do this, attach a letter to your income return for the year you bought the property. In the letter, list the properties you are including in a separate class.

You should also note that if you acquire a depreciable property during the year, you cannot claim the full amount of the capital cost allowance in that year. Generally, your claim for the first year on that asset is limited to 50% of the amount that you would otherwise be allowed.

Example
The following is an example of a capital cost allowance chart.

You are starting up a new business. There are no assets in the class before your current purchases. You purchase $5,000 worth of welding equipment, and enter it into class 8 on the schedule, as follows:

Column 1 – refers to the class of assets, which is class 8 in this example.

Column 2 – shows the cost of the assets, less the capital cost allowance you have already claimed. Since you are starting a new business, this amount is nil.

Column 3 – shows the total dollar value of any additions to the class, which in this case is $5,000.

Column 4 – shows the proceeds from the sale of any assets in the class. In this case, you did not sell any assets. The amount to be included as proceeds from disposals cannot exceed the original cost of the asset. Any excess would be treated as a capital gain.

Column 5 – shows the balance currently in the class (e.g., the previous amount **plus** additions **minus** any dispositions).

Column 6 – is where the 50% rule, discussed earlier, comes into play. Subtract one-half of the net additions for the year, since you are only allowed one-half of the capital cost allowance in the first year that you acquire an asset. In this example, subtract one-half of your additions, or $2,500.

Column 7 – shows the balance remaining, or $2,500. This is the amount on which you claim capital cost allowance for the year.

Column 8 – shows the applicable rate. For class 8, the rate is 20%.

Column 9 – shows the maximum dollar amount that you can claim for the year. You can claim a lesser amount, if you wish. In this example, it amounts to 20% of $2,500, or $500. This is the capital cost allowance that you claim as a business expense on your income statement.

Column 10 – shows the amount that is left in the class at the end of the year. Note that you started with nothing in the class, added assets worth $5,000, and deducted a claim for $500 capital cost allowance. Therefore, the balance at the end of the year is $4,500.

Capital cost allowance (CCA) schedule – Part XI properties

(1) Class	(2) Undepreciated capital cost (UCC) – beginning	(3) Additions	(4) Disposals	(5) UCC balance	(6) Adjustments for current-year additions	(7) Base amount for CCA	(8) Rate (%)	(9) CCA for the year	(10) UCC at the end of the year
8	Nil	$5,000	Nil	$5,000	$2,500	$2,500	20	$500	$4,500

Use Form T2124, T2032, T2042, T2121, T1163, or T1164 (see below).

There are three other points you should remember:

- If, at the end of the taxation year, the balance in the class of assets column (10) is **negative**, add this amount into income on your income statement. Set the balance in the class at zero. This is known as **recaptured capital cost allowance**. You will start the next year with an opening balance of zero in that particular class.
- If, at the end of the taxation year, the balance in column (10) is **positive**, but there are no assets in the class, deduct the positive balance from income on your income statement. Set the balance in the class at zero. This is known as a **terminal loss**. You will start the next year with an opening balance of zero in that particular class.
- You may incur GST/HST on the depreciable property you acquire for your business. If you incur GST/HST and you are a GST/HST registrant, you may be able to claim a tax credit on your GST/HST return. The input tax credit is government assistance. Therefore, subtract it from the property's undepreciated capital cost (column 2) in the year you receive it.

To calculate your claim for capital cost allowance, use one of the following forms:

- T2124, *Statement of Business Activities*
- T2032, *Statement of Professional Activities*
- T2042, *Statement of Farming Activities*
- T2121, *Statement of Fishing Activities*
- T1163, *NISA Account Information and Statement of Farming Activities for Individuals*
- T1164, *NISA Account Information and Statement of Farming Activities for Additional Farming Operations*

For detailed instructions and examples of how to calculate capital cost allowance, get one of the following guides: T4002, *Business and Professional Income*; T4003, *Farming Income*; RC4060, *Farming Income and CAIS Program*, or T4004, *Fishing Income*. Schedule 8 is the form that corporations use.

6. Operating expenses

This part deals with the more common expenses that you incur to earn income from your business or professional practice. **Incur** means that you either paid or will have to pay the expense.

As a rule, you can deduct any reasonable expense you incur to earn business income. The expenses you can deduct include any GST/HST you incur on these expenses. As a GST/HST registrant, you claim input tax credits for GST/HST you paid or that was payable on your operating expenses. Apply your input tax credits against GST/HST you collected or charged on taxable sales and services. Input tax credits allow you to recover GST/HST you paid or that was payable on goods or services you acquired for use in your commercial activities. However, you cannot deduct personal expenses or expenses you incur to buy capital property.

For more detailed information, get Interpretation Bulletin IT-128, *Capital Cost Allowance – Depreciable Property*.

If, after reading this bulletin, you still have questions about which expenses you can deduct, visit our Web site at **http://www.cra.gc.ca/tax/business/topics/solepartner/allabout/businessexpenses/menu-e.html** or call us at **1-800-959-5525**.

Prepaid expenses

A prepaid expense is an expense you pay before it is due. Under the accrual method of accounting, claim any expense you prepay in the year or years in which you receive the related benefit.

For example, your fiscal year-end is December 31, 2004. On June 30, 2004, you prepay the rent on your business store for a full year (July 1, 2004, to June 30, 2005). You can only deduct one-half of this rent as an expense in 2004. You deduct the other half as an expense in 2005. You can claim a full input tax credit for GST/HST you paid on business rent.

For more information, get Interpretation Bulletin IT-417, *Prepaid Expenses and Deferred Charges*.

Accounting and legal fees

Deduct the fees you incurred for external professional advice or services, including consulting fees.

You can deduct accounting and legal fees you incur to get advice and help in keeping your books and records. You can also deduct fees you incur for preparing and filing your income tax and GST/HST returns.

You can deduct accounting or legal fees you paid to have an objection or appeal prepared against an assessment for income tax, Canada Pension Plan or Quebec Pension Plan contributions, or Employment Insurance premiums. However, the full amount of these deductible fees must first be reduced by any reimbursement of these fees that you have received. Enter the difference on line 232 of your income tax return. If you received a reimbursement this year for the types of fees that you deducted in a previous year, report the amount you received on line 130 of this year income tax return.

You cannot deduct legal and other fees you incur to buy a capital property. Instead, add these fees to the cost of the property.

For more details about capital property, see Chapter 4 of the guide T4002, *Business and Professional Income*. For more information about accounting and legal fees see Interpretation Bulletin IT-99, *Legal and Accounting Fees.*

Advertising

You can deduct expenses for advertising. This includes ads in Canadian newspapers and on Canadian television and radio stations. You can also include any amount you paid as a finder's fee.

Certain restrictions apply to the amount of the expense you can deduct for advertising in a periodical. You can deduct all the expense if your advertising is directed to a Canadian market and the original editorial content in the issue is 80% or more of the total non-advertising content in the issue.

You can deduct 50% of the expense if your advertising in a periodical is directed to a Canadian market and the original editorial content in the issue is less than 80% of the total non-advertising content in the issue.

Also, you cannot deduct expenses for advertising directed mainly to a Canadian market when you advertise with a foreign broadcaster.

Business tax, fees, licences, dues, memberships, and subscriptions

You can deduct any annual licence fees and business tax you incur to run your business.

You can also deduct annual dues or fees to keep your membership in a trade or commercial association. You cannot deduct club membership dues (including initiation fees) where the main activities are dining, recreation, or sport.

Insurance premiums

You can deduct all regular commercial insurance premiums you incur on any buildings, machinery, and equipment that you use for your business.

Interest and bank charges

You can deduct the interest you incur on money you borrow to run your business. However, some limits apply.

There is a limit on the interest you can deduct on money you borrow to buy a passenger vehicle. For more information, see "Motor vehicle expenses" in the guide T4002, *Business and Professional Income*.

There is a limit on the amount of interest you can deduct for **vacant land**. See "Interest" in the guide T4002, *Business and Professional.*

You can also capitalize the interest you pay on the money you borrow:

- to buy depreciable property;
- to buy a resource property; or
- for exploration and development.

When you choose to capitalize interest, you add the interest to the cost of the property or exploration and development costs, instead of deducting the interest as a current expense.

Maintenance and repairs

You can deduct the cost of labour and materials for any minor repairs or maintenance done to property you use to earn income. You cannot deduct the value of your own labour.

You cannot deduct costs you incur for repairs that are capital in nature. However, you may be able to claim capital cost allowance. For more information about capital cost allowance, see Chapter 4 of the guide T4002, *Business and Professional Income*.

Meals and entertainment

The maximum part you can claim for food, beverages, and entertainment expenses is 50% of either the amount you incur or an amount that is reasonable in the circumstances, whichever is less. These limits also apply to the cost of your meals when you travel or go to a convention, conference, or similar event. However, special rules can affect your claim for meals in these cases.

For more details, see "Meals and entertainment," "Convention expenses," or "Travel" in the guide T4002, *Business and Professional Income*, and Interpretation Bulletin IT-518, *Food, Beverages and Entertainment Expenses.*

Motor vehicle expenses

You can deduct expenses you incur to run a motor vehicle that you use to earn business income.

Keeping records

You can deduct motor vehicle expenses only when they are reasonable and you have receipts to support them. To get the full benefit of your claim for each vehicle, keep a record of the total kilometres you drove, and the kilometres you drove to earn business income. For each business trip, list the date, destination, purpose, and the number of kilometres. Be sure to write down the odometer reading of each vehicle at the start and end of the fiscal period.

If you change motor vehicles during the fiscal period, write down the odometer reading at the time you buy, sell, or trade the vehicle. Be sure to write down the dates too.

What kind of vehicle do you own?

The kind of vehicle you own can affect the expenses you deduct. For income tax purposes there are three types of vehicles:

Motor vehicle – This is an automotive vehicle designed or adapted for use on highways and streets. A motor vehicle does not include a trolley bus or a vehicle designed or adapted to operate only on rails.

Automobile – This is a motor vehicle designed or adapted primarily to carry people on highways and streets. It seats a driver and no more than eight passengers.

An automobile does not include:

- an ambulance;
- clearly marked police and fire emergency-response vehicles;
- a motor vehicle you bought to use more than 50% as a taxi, a bus used in the business of transporting passengers, or a hearse in a funeral business;
- a motor vehicle you bought to sell, rent, or lease in a motor vehicle sales, rental, or leasing business;
- a motor vehicle (except a hearse) you bought to use in a funeral business to transport passengers;
- a van, pick-up truck, or similar vehicle that seats no more than the driver and two passengers which, in the tax year you bought or leased, was used more than 50% to transport goods and equipment to earn income;
- a van, pick-up truck, or similar vehicle that, in the tax year you bought or leased, was used 90% or more to transport goods, equipment, or passengers to earn income; and

- a pick-up truck that, in the tax year you bought or leased, was used more than 50% to transport goods, equipment, or passengers while earning or producing income at a remote work location or at a special work site that is at least 30 kilometers from the nearest community having a population of at least 40,000 persons.

Passenger vehicle – This is an automobile you bought after June 17, 1987. A passenger vehicle is also an automobile that you leased under an agreement you entered into, extended, or renewed after June 17, 1987.

Most cars, station wagons, vans, and some pick-up trucks are passenger vehicles. They are subject to the limits for CCA, interest, and leasing. For definitions and more detailed information about capital cost allowance limits, interest limits, and leasing costs, get the guide T4002, *Business and Professional Income*.

To help you determine where your vehicle fits in, see the following chart. It does not cover every situation, but gives you some idea of how the definitions work. The chart is for a vehicle you buy or lease after June 17, 1987, that you use to earn business income.

Vehicle definitions

Type of vehicle	Seating (including driver)	Business use in year bought or leased	Vehicle definitions
Coupe, sedan, station wagon, sports, or luxury car	1 to 9	1% to 100%	Passenger
Pick-up truck to transport goods or equipment	1 to 3	More than 50%	Motor
Pick-up truck (other than above)*	1 to 3	1% to 100%	Passenger
Pick-up truck with extended cab to transport goods, equipment, or passengers	4 to 9	90% or more	Motor
Pick-up truck with extended cab (other than above)*	4 to 9	1% to 100%	Passenger
Sport-utility to transport goods, equipment, or passengers	4 to 9	90% or more	Motor
Sport-utility (other than above)	4 to 9	1% to 100%	Passenger
Van or minivan to transport goods or equipment	1 to 3	More than 50%	Motor
Van or minivan (other than above)*	1 to 3	1% to 100%	Passenger
Van or minivan to transport goods, equipment, or passengers	4 to 9	90% or more	Motor
Van or minivan (other than below)	4 to 9	1% to 100%	Passenger

* A vehicle in this category is considered a motor vehicle if it is used more than 50% of the time to transport goods, equipment, or passengers while earning or producing income at a remote work location or at a special work site. Also, the work location or site must be at least 30 kilometres from the nearest community having a population of 40,000 persons.

Deductible expenses

The types of expenses you can deduct include:

- fuel cost
- maintenance and repairs
- insurance
- licence and registration fees
- capital cost allowance
- interest you pay on a loan used to buy the motor vehicle
- leasing costs

Joint ownership

If you and another person own or lease a passenger vehicle together, the limits on capital cost allowance, interest, and leasing still apply. As a joint owner, you are allowed to deduct no more than the total amount that one person alone could deduct when owning or leasing a vehicle.

Business use of a motor vehicle

If you use a motor vehicle for both business and personal use, you can deduct only the part of the expenses that you paid to earn income.

However, you can deduct the full amount of parking fees related to your business activities and supplementary business insurance for your motor vehicles.

To support the amount you can deduct, keep a record of both the total kilometres you drove and the kilometres you drove to earn income.

Example
Jay owns a stereo retail business that has a December 31 year-end. He has a van that he uses for the business. In keeping his records, Jay wrote down the following for 2004:

Kilometres driven to earn business income	27,000
Total kilometres driven	30,000

Expenses:

Gas and oil	$2,400
Insurance	1,900
Interest	800
Licence and registration fees	100
Maintenance and repairs	200
Total expenses for the van	**$5,400**

Jay calculates the expenses he can deduct for his van in 2004 as follows:

$$\frac{27{,}000 \text{ (business kilometres)}}{30{,}000 \text{ (total kilometres)}} \times \$5{,}400 = \$4{,}860$$

When you use more than one motor vehicle to earn income, calculate each vehicle's expenses separately.

Interest

You can deduct interest on money you borrow to buy a motor vehicle, automobile, or passenger vehicle that you use to earn income. Include the interest as an expense when you calculate your allowable motor vehicle expenses.

When you use a passenger vehicle to earn business income, there is a limit on the amount of interest you can deduct. See the guide T4002, *Business and Professional Income* for more information on claiming this expense.

Leasing

You can deduct amounts you incur to lease a motor vehicle that you use to earn business income. Include the leasing costs when you calculate your allowable motor vehicle expenses.

When you use a passenger vehicle to earn income, there is a limit on the amount of the leasing costs you can deduct. To calculate your eligible leasing costs, see the guide T4002, *Business and Professional Income*.

Note
Generally, leases include taxes (i.e., GST/HST and PST) but do not include items such as insurance and maintenance. You have to pay these amounts separately. Therefore, list these expenses separately when you calculate your allowable motor vehicle expenses.

Office expenses

You can deduct office expenses you incur to earn business income. In this case, an **office** is a business office or property that is outside the home you live in. Do not confuse office expenses with the business-use-of-home expenses.

The following list is an example of types of office expenses, and gives you an idea of what you can deduct for your business office or property:

- heat
- electricity
- insurance
- mortgage interest
- property taxes or rent
- telephone
- water

For more details on home offices expenses, see IT-514, *Work Space in Home Expenses.*

Salaries, including employer's contributions

You can deduct salaries you pay to employees. Report these salaries on a T4 or T4A slip. For more details on how to complete these forms see the Employers' Guide T4001, *Payroll Deductions (Basic Information)*.

As the employer, you can deduct your part of Canada Pension Plan (CPP) contributions, Employment Insurance (EI) premiums, and workers' compensation board amounts. You can also deduct any premiums you pay on behalf of an employee for a sickness, accident, disability, or income insurance plan.

When you pay your employees, you usually withhold CPP contributions, EI premiums, and income tax for them. There can be exceptions to this rule. For more details on withholding and the exceptions, see the Employers' Guide T4001, *Payroll Deductions (Basic Information)*.

You can deduct the salary you pay to your child as long as **all** of these conditions apply:

- you pay the salary;
- the work your child does is necessary for earning business or professional income; and
- the salary is reasonable when you consider your child's age, and the amount you pay is what you would pay someone else.

Keep documents to support the salary you pay your child. If you pay your child by cheque, keep the cancelled cheque. If you pay cash, have the child sign a receipt.

For more information about salaries, see the guide T4002, *Business and Professional Income*.

Other expenses

There are other expenses that you can incur. Some of them are outlined in the guide T4002, *Business and Professional Income*. These expenses include the following:

- eligible capital property
- allowable reserves
- bad debts
- business use of home
- conventions
- capital cost allowance
- computers and other equipment
- office supplies
- travelling
- telephone
- private health services plan (PHSP)

7. Land

The purchase of land is not an allowable business expense since land is generally a capital asset with an indefinite life. However, it can also be an inventory asset held for resale. Also, since land is not a depreciable asset (i.e., it does not wear out or become obsolete over time), you cannot claim a deduction for capital cost allowance.

As a result of this, special rules apply if you acquire a property that includes land and a building. You have to allocate the purchase price between the land and the building on a reasonable basis. By doing this, you can add the cost of the building to the capital cost allowance chart.

You must also allocate any fees relating to the purchase, such as legal, accounting, and engineering fees, between the land and building on the same basis on which you allocated the purchase price.

For more information, see the guide T4002, *Business and Professional Income* and Interpretation Bulletin IT-218, *Profit, Capital Gains and Losses From the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate From Capital Property to Inventory and Vice Versa*.

8. Start-up costs

Commencement of Business operations

To be able to deduct an amount on the grounds that it was an expense incurred for the purpose of gaining or producing income from a business, you have to have been carrying on business in the fiscal period in which the expense was incurred.

Therefore, when you propose to start a business and make some initial expenditures with that purpose in mind, you have to determine if they preceded the beginning of the business, or if the business had in fact started and they were expenses incurred during preliminary steps leading to the start of usual operations. As a result, you have to know the date when the business can be said to have started.

Date when business commences

It is not possible to be specific about the point in time when a contemplated business becomes an actual business. We consider a business to have started whenever there is significant activity that is a regular part of the income-earning process in that type of business, or that is an essential preliminary to usual operation. For more information, get Interpretation Bulletin IT-364, *Commencement of Business Operations*.

More than One Business

A person, whether a corporation or an individual, may occasionally be carrying on business activities that consist of two or more separate businesses (see interpretation bulletin IT-206, *Separate businesses.* Where such is the case, each business must be considered separately where it is necessary to determine the date of commencement of one of the business.