



Canada Revenue
Agency

Agence du revenu
du Canada

Reconciliation of Business Income for Tax Purposes

Includes Form T1139

2006

Before you start

Is this guide for you?

Use this guide if you are a professional or self-employed individual (including a self-employed commission salesperson) and the usual fiscal period of your business or professional practice **does not end on December 31, 2006**. Also, use this guide if you completed Form T1139, *Reconciliation of 2005 Business Income for Tax Purposes*, in 2005.

This guide will help you calculate the business or professional income to enter on your Form T1139 and report on your 2006 income tax return.

However, if you converted to a December 31 year-end in a previous year, you do not have to use this guide.

If you started your business in 2006 and your first fiscal period ends in 2007, choose a fiscal period other than the calendar year by filing an election with your income tax return. To help you calculate the amount of business income to report on the appropriate line of your 2006 income tax return, see Part 2 of Chapter 2.

This guide complements our guides called *Business and Professional Income*, *Farming Income*, *Farming Income and the CAIS Program*, and *Fishing Income*.

Forms and publications

In the middle of this guide, you will find two copies of Form T1139, *Reconciliation of 2006 Business Income for Tax Purposes*. Throughout the guide, we refer to other forms and publications. If you need any of these, visit our Web site at www.cra.gc.ca. You may want to bookmark this address for easier access to our site in the future. You can also order forms and publications by calling us at 1-800-959-2221.

Point. Click. It's that quick!

That's all it takes to get tax information when you need it. Visit www.cra.gc.ca today and find out how easy managing your taxes can be.

The Canada Revenue Agency wants to decrease the demand for paper. Accessibility to the Internet continues to increase. In the future, we encourage you to view this guide on our Web site at www.cra-arc.gc.ca/E/pub/tg/rc4015 and print only the parts you need.

If you have a visual impairment, you can get our publications and your personalized correspondence in braille, large print, or etext (CD or diskette), or on audio cassette or MP3. For details, visit our Web site at www.cra.gc.ca/alternate or call **1 800 959 2221**.

La version française de cette publication est intitulée *Conciliation du revenu d'entreprise aux fins de l'impôt*.

What's new for 2006?

All references to the 10 year reserve have been removed. This reserve has expired.

My Business Account

My Business Account, Canada Revenue Agency's (CRA's) new online service, provides convenient and secure access to a growing range of personalized business account information and services. In the fall of 2007, *My Business Account* will also offer access for authorized third parties and a full range of business account options.

Visit www.cra.gc.ca/mybusinessaccount to find out more about this exciting addition to our suite of electronic services for business.

Teletypewriter users

If you use a teletypewriter (TTY), you can call our toll-free, bilingual enquiry service at 1-800-665-0354.

Do you need more information?

This guide uses plain language to explain the most common tax situations. If, after reading this guide, you need more information, call our Business Enquiries line at 1-800-959-5525.

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Chapter 1 – General information

Generally, you have to report your business income from a business carried on in Canada on a calendar-year basis. This rule affects sole proprietorships, professional corporations that are partners of a partnership, and partnerships (in which at least one partner of the partnership is an individual, professional corporation, or another affected partnership).

You may be able to use an alternative method of reporting your business income that is available on a business-by-business basis. This alternative method, which allows you to have a fiscal period that does not end on December 31, applies to individuals and partnerships in which all the partners are individuals. An individual who is a partner of a partnership that includes a professional corporation as a partner cannot use the alternative method. Also, partnerships that are partners of other partnerships cannot use the alternative method.

If you are an eligible individual (including an individual who is a partner of an eligible partnership) who wants to have a fiscal period that does not end on December 31, you will have to file an election with your income tax return to keep that period. If you filed an election in previous years for a business, you do not have to file an election for the 2006 taxation year for that business. You have to use Form T1139, *Reconciliation of 2006 Business Income for Tax Purposes*, to file your election on or before the filing due date of your income tax return. A partner who has authority to act for a partnership can make a valid election for a partnership. All the partners of the partnership have to complete a copy of this form and include it with their income tax returns to reconcile their share of the net business income (loss) for the 2006 tax year.

Note

If you are a goods and services tax/harmonized sales tax (GST/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.

Filing and balance due dates

You may have self-employment income or you may be the spouse or common-law partner of someone who does. If so, you have until June 15, 2007, to file your income tax return and Form T1139, unless the expenditures made to carry on the business are mainly the cost or capital cost of tax shelter investments. However, you have to pay any tax owing by April 30, 2007.

Note

If any of the dates mentioned above fall on a Saturday, Sunday, or statutory holiday, you have until the next business day to file your return or make your payment.

Chapter 2 – Calculating your 2006 business income

Existing businesses – Started before 2006

If you filed Form T1139 with your 2005 income tax return, you also have to file this form with your 2006 income tax return to calculate your additional business income in Part 2. Complete the part that applies to your situation by following the instructions in this chapter.

You may have started your business in 2005, and your first fiscal period ended in 2006, but you did not elect to complete Part 2 of Form T1139 and report business income in 2005. If so, you have to complete Form T1139 for the 2006 tax year.

New businesses – Started in 2006

If you started your business in 2006 and chose a December 31 year-end, you do not have to complete Form T1139. If you started your business in 2006 and your first fiscal period ends in 2007, you can choose to complete Part 2 of Form T1139 and report business income in 2006. For more information, see Part 2 of this chapter.

Form T1139, *Reconciliation of 2006 Business Income for Tax Purposes*

This form has two parts. Part 1 deals with calculating your business income if you change or have already changed your fiscal period end to December 31. Part 2 deals with calculating your business income if you elect or have already elected to have a fiscal period that does not end on December 31. We refer to this as the alternative method. Use Part 2 to revoke a previously filed election. Use Form T1139 only for businesses carried on in Canada.

If you have more than one business with fiscal periods that do not end on December 31, you could complete both Part 1 and Part 2 of Form T1139. For example, you could **convert** one business to a December 31 year-end, and **elect** to keep a fiscal period that does not end on December 31 for the other business.

Form T1139 can accommodate more than one business. If you have more than two businesses in either part, use a **separate sheet** to provide the required information. **Do not** file more than one Form T1139.

The rest of this chapter explains each part and line of the form in detail.

Identification area

Enter your social insurance number (SIN) in the appropriate area. Enter your 15-digit Business Number (BN) in the appropriate area. If you have more than one BN, enter the number for your proprietorship.

Part 1 – Converting to a December 31 fiscal period end

Part 1 applies only to existing businesses that started before 2006 and completed Form T1139 last year.

Complete Part 1 of the form if you changed your fiscal period end to December 31 in a previous year. You should also complete this part if you elected to keep a year-end other than December 31 and you now want to convert it to December 31. If you choose this option, you have to report your business income on a calendar-year basis in later years. This part will help you calculate the amount of business income to report on the appropriate line of your 2006 income tax return.

Line A – Net income (loss) for your first fiscal period ending in 2006

Line A applies only to existing businesses that started before 2006 and that are converting to a December 31 year-end in 2006. If you converted to a December 31 year-end previously, you should start at line B.

The amount on line A represents the net income (loss) of your first fiscal period ending in 2006. For example, if your fiscal period began July 1, 2005, and ended June 30, 2006, the amount to enter on line A is the net income (loss) for the fiscal period ending June 30, 2006.

Note

If you have more than one fiscal period that does not end on December 31 for the same business, the net income (loss) of your first fiscal period above is the total of the net income (loss) of these fiscal periods.

For each business, enter on line A the amount of your net income (loss) from your income and expense statement. This is the amount on line 9946 of the following forms:

- T2124, *Statement of Business Activities*;
- T2032, *Statement of Professional Activities*;
- T2121, *Statement of Fishing Activities*;
- T2042, *Statement of Farming Activities*;
- T1163, *Statement A – CAIS Program Information and Statement of Farming Activities for Individuals*;
- T1164, *Statement B – CAIS Program Information and Statement of Farming Activities for Additional Farming Operations*;
- T1273, *Statement A – Harmonized CAIS Program Information and Statement of Farming Activities for Individuals*;
- T1274, *Statement B – Harmonized CAIS Program Information and Statement of Farming Activities for Additional Farming Operations*.

If you are a partner of a partnership, enter on line A your share of the partnership's net business or professional income (loss) for the first fiscal period ending in 2006. If you have deductible expenses from your share of the net partnership business income, subtract these amounts before entering your share of the net partnership income (loss) on line A. For more information on expenses deductible from your share of the net partnership income (loss), see "Other

amounts deductible from your share of net partnership income (loss)" in the guide that applies to your type of business income.

If you are a partner of a partnership and you received a T5013 slip, *Statement of Partnership Income*, enter on line A the amount from box 35 or 37 for your share of business income for the period ending December 31, 2006.

Form T1139 can accommodate more than one business. If you have more than two businesses, attach a separate sheet listing the net income (loss) for each additional business.

Line B – Net income (loss) for the period ending December 31, 2006

Line B applies to existing businesses that started before 2006 which converted to a December 31 year-end in a previous year. In this case, the net income (loss) you report on this line is from January 1, 2006, to December 31, 2006.

This line also applies to existing businesses that started before 2006 and decided to convert to a December 31 year-end in 2006. In this case, enter on line B the net income (loss) of your fiscal period ending December 31, 2006. For example, if your first 2006 fiscal period ended on June 30, 2006, the amount to enter on line B is the net income (loss) for the period July 1, 2006, to December 31, 2006. You will have to prepare an income and expense statement for this period for each business.

Your net income (loss) is the amount on line 9946 if for your December 31, 2006, fiscal period you used:

- Form T2124, *Statement of Business Activities*;
- Form T2032, *Statement of Professional Activities*;
- Form T2121, *Statement of Fishing Activities*;
- Form T2042, *Statement of Farming Activities*;
- Form T1163, *Statement A – CAIS Program Information and Statement of Farming Activities for Individuals*;
- Form T1164, *Statement B – CAIS Program Information and Statement of Farming Activities for Additional Farming Operations*;
- T1273, *Statement A – Harmonized CAIS Program Information and Statement of Farming Activities for Individuals*;
- T1274, *Statement B – Harmonized CAIS Program Information and Statement of Farming Activities for Additional Farming Operations*.

If you are a partner of a partnership, enter your share of the partnership's net business or professional income (loss) on line B. If you have deductible expenses that relate to this income that you did not deduct on line A, subtract these amounts before entering your share of the net partnership income (loss) on line B. For more information on expenses deductible from your share of the net partnership income (loss), see "Other amounts deductible from your share of net partnership income (loss)" in the guide that applies to your type of business income.

If you are a partner of a partnership and you received a T5013 slip, *Statement of Partnership Income*, enter on line B

the amount of business or professional income from box 35 or 37 for the period ending December 31, 2006.

Form T1139 can accommodate more than one business. If you have more than two businesses, attach a separate sheet listing the net income (loss) for each additional business.

Additional information for line B if you are converting to a December 31 fiscal period end in 2006

Generally, you calculate the income and expenses of your fiscal period ending on December 31, 2006, in the same way as your previous fiscal period ending in 2006. However, you have to consider the following items:

Reserves – In your fiscal period ending on December 31, 2006, add any reserves you deducted in your previous fiscal period ending in 2006. For more information on allowable reserves, see Guide T4002, *Business and Professional Income*.

Opening inventory and closing inventory – The opening inventory for your fiscal period ending on December 31, 2006, is the amount of the closing inventory of your previous fiscal period ending in 2006. The closing inventory as of December 31, 2006, will be the opening inventory for your 2007 fiscal period. For more information on opening and closing inventory, see Guide T4002, *Business and Professional Income*.

Work-in-progress (WIP) – The WIP at the beginning of your fiscal period ending on December 31, 2006, is the amount of the WIP at the end of your previous fiscal period ending in 2006. For more information on WIP, see Guide T4002, *Business and Professional Income*.

Capital cost allowance (CCA) – The undepreciated capital cost (UCC) of depreciable property at the start of your fiscal period ending on December 31, 2006, is the UCC at the end of the previous fiscal period ending in 2006. Similarly, the UCC at the end of your fiscal period ending December 31, 2006, is the UCC at the start of your 2007 fiscal period.

For your fiscal period ending on December 31, 2006, you generally have to prorate your maximum claim for CCA based on the number of days in that fiscal period. For example, if your fiscal period ending on December 31, 2006, is 214 days, and you would otherwise calculate your maximum CCA to be \$3,500 for a full year, the maximum amount of CCA you can claim is \$2,052 ($\$3,500 \times 214/365$). For more information on CCA, see the guide that applies to your type of business income.

Business-use-of-home expenses – In your fiscal period ending on December 31, 2006, you can claim any deductible business-use-of-home expenses you could not use in the previous fiscal period ending in 2006. Similarly, you can carry forward to your 2007 fiscal period any deductible business-use-of-home expenses you could not use in your fiscal period ending December 31, 2006. For more information on business-use-of-home expenses, see the guide that applies to your type of business income.

Line C – Subtotal (line A plus line B)

Enter on line C the total of the amounts on lines A and B. Calculate this total for each business. If you have more than

two businesses and you attached a separate sheet, remember to subtotal each business on line C.

Line D – Last year’s additional business income

If you converted to a December 31 fiscal period end in 2006, enter on line D last year’s additional business income from line H on last year’s Form T1139.

Line E – Net income (loss) for each business

Enter on line E the amount of line C minus line D. Calculate this total for each business. If you have more than two businesses and you attached a separate sheet, remember to do the same calculation for each business.

Enter the amount(s) on line E on the appropriate line(s) of your income tax return.

Part 2 – Electing to have a fiscal period that does not end on December 31 (alternative method)

This election, which is available on a business-by-business basis, applies to individuals and partnerships in which all the partners are individuals. However, partnerships that are partners of another partnership cannot use the alternative method. Also, you cannot use the alternative method for a business if the expenditures made in the course of carrying on the business are primarily the cost or capital cost of tax-shelter investments.

Part 2 usually applies to businesses that started before 2006 and elected to keep a fiscal period that does not end on December 31.

If you started your business in 2006 and your first fiscal period ends in 2007, you can elect to complete Part 2 and report business income in 2006. For more information, see “New businesses starting in 2006 with a first fiscal period ending in 2007” on page 7.

Part 2 will help you calculate the amount of business income to report on the appropriate line of your 2006 income tax return.

Line F – Net income (loss) for your fiscal period ending in 2006

This is the net income (loss) for your fiscal period ending in 2006. For example, if your fiscal period began June 1, 2005, and ended May 31, 2006, the amount to enter on line F is the net income (loss) for the fiscal period ending May 31, 2006.

Note

If you have more than one fiscal period that does not end on December 31 for the same business, the net income (loss) of your fiscal period on line F is the total of the net income (loss) of these fiscal periods.

For each business, enter on line F the amount of your net income (loss) from your income and expense statement. This is the amount on line 9946 of the following forms:

- T2124, *Statement of Business Activities*;
- T2032, *Statement of Professional Activities*;
- T2121, *Statement of Fishing Activities*;

- T2042, *Statement of Farming Activities*;
- T1163, *Statement A – CAIS Program Information and Statement of Farming Activities for Individuals*;
- T1164, *Statement B – CAIS Program Information and Statement of Farming Activities for Additional Farming Operations*;
- T1273, *Statement A – Harmonized CAIS Program Information and Statement of Farming Activities for Individuals*;
- T1274, *Statement B – Harmonized CAIS Program Information and Statement of Farming Activities for Additional Farming Operations*.

If you are a partner of a partnership, enter on line F your share of the partnership's net business or professional income (loss) for the fiscal period ending in 2006. If you have incurred expenses during the fiscal period of the partnership that are deductible from your share of the net partnership business income, subtract these amounts before entering your share of the net partnership income (loss) on line F. For more information on these expenses, see "Other amounts deductible from your share of net partnership income (loss)" in the guide that applies to your type of business income.

If you are a partner of a partnership and you received a T5013 slip, *Statement of Partnership Income*, enter on line F the amount from box 35 or 37 of your slip.

Form T1139 can accommodate more than one business. If you have more than two businesses, attach a separate sheet listing the net income (loss) for each additional business.

Line G – Additional business income

To calculate the additional business income on line G for each business, use this formula:

$$(A - B) \times C/D$$

A is your net business income, if any, for the fiscal period(s) ending in 2006. This is the amount on line F of your Form T1139 for each business;

B is the lesser of:

- i) the total amount included in A above that is considered to be a taxable capital gain for the capital gains deduction; and
- ii) your total capital gains deduction **deducted** for 2006;

C is the number of days you carry on the business after the end of the fiscal period up to and including December 31, 2006; and

D is the number of days you carry on the business that are in the fiscal period(s) ending in 2006.

Note

If the amount you calculate with the formula is negative, we consider it to be nil.

Example

Paul owns an appliance business with a fiscal period that starts on February 1, 2005, and ends on January 31, 2006.

Paul's net income from the business for the fiscal period that ends on January 31, 2006, is \$45,000. Paul enters this amount on line F of his Form T1139. There is no income from the disposition of capital property for the business.

Paul calculates his additional business income in 2006 as follows:

$$(A - B) \times C/D$$

$$A = \$45,000$$

$$B = 0$$

$$C = 334 \text{ days (365 days - 31 days in January)}$$

$$D = 365 \text{ days (the number of days in the fiscal period ending on January 31, 2006, during which Paul carried on the business)}$$

The amount of additional business income is \$41,178 $(\$45,000 - 0) \times 334/365$. Paul enters this amount on line G of Form T1139.

Form T1139 can accommodate more than one business. If you have more than two businesses, attach a separate sheet listing the additional business income for each business.

New businesses starting in 2006 with a first fiscal period ending in 2007

If you started your business in 2006 and your first fiscal period ends in 2007, you can elect to include an amount of business income in 2006. In this case, for 2006, the amount of business income to enter on line G is the lesser of:

- i) any amount you designate as your additional business income; and
- ii) the amount determined by the formula

$$(A - B) \times C/D$$

A is your net business income for the fiscal period ending in 2007 (see note below);

B is the lesser of:

- i) the total amount included in A above that is considered to be a taxable capital gain for the capital gains deduction; and
- ii) your total capital gains deduction **deducted** for 2007;

C is the number of days you carry on the business in 2006 that are in the fiscal period ending in 2007; and

D is the number of days you carry on the business that are in the fiscal period ending in 2007.

Note

If amounts A or B are not known, use reasonable estimated amounts. If the amount you calculate with the formula is negative, we consider it to be nil. If you report an amount on line G and line J of Form T1139, you must also report an amount of gross business income on the appropriate line of your income tax return.

Line H – Subtotal (line F plus line G)

Enter on line H the total of the amounts on lines F and G. Calculate this total for each business. If you have more than two businesses and you attached a separate sheet, remember to subtotal each business on line H.

Line I – Last year's additional business income

For each business, enter on line I the amount included on line H on last year's Form T1139.

Line J – Net income (loss) for each business

Enter on line J the result of line H minus line I. Calculate this amount for each business. If you have more than two businesses and you attached a separate sheet, remember to do the same calculation for each business.

Enter the amount(s) on line J on the appropriate line(s) of your tax return.

Death of partner or proprietor in the year

If an individual who uses the alternative method dies after the end of the regular fiscal period of the business, the legal representative can elect to file an optional income tax return (optional return), including Form T1139, to report the business income from the end of the regular fiscal period until the date of death (short fiscal period). This means that the legal representative will complete two income tax returns (including two T1139 forms) for the 2006 year as follows:

- a final income tax return (including Form T1139) for the business income from the regular fiscal period and all other income; and
- an optional income tax return (including Form T1139) for the business income from the short fiscal period.

Final income tax return (including Form T1139) for the regular fiscal period

In this case, the final income tax return includes the business income from the regular fiscal period and all other income. The legal representative completes the financial statements and Form T1139 in the usual way. Form T1139 for the regular fiscal period includes the following items:

- On line F, enter the net income (loss) for the regular fiscal period ending in 2006.
- On line G, enter the 2006 additional business income calculated using the following formula:

$$(A - B) \times C/D$$

A is the net business income, if any, for the fiscal period(s) ending in 2006 other than the short fiscal period. This is the amount on line F of Form T1139 for the business;

B is the lesser of:

- i) the total amount included in A above that is considered to be a taxable capital gain for the capital gains deduction; and
- ii) the total capital gains deduction **deducted** for 2006;

C is the number of days the business is carried on after the end of the 2006 fiscal period, up to and including the date of death; and

D is the number of days the business is carried on that are in the regular fiscal period(s) ending in 2006.

Note

If the amount you calculate with the formula is negative, we consider it to be nil.

- On line I, enter last year's additional business income from line H.

- On line J the net income (loss) for each business is the amount of line H minus line I.

Optional income tax return (including Form T1139) for the short fiscal period

In this case, the optional income tax return includes the business income for the short fiscal period. The legal representative completes the financial statements and Form T1139 from the end of the regular fiscal period until the date of death. However, Form T1139 for the short fiscal period includes the following items:

- On line F, enter the net income (loss) from the end of the regular fiscal period until the date of death.
- On line I, enter the additional business income from line G of Form T1139 for the final income tax return.
- On line J, the net income (loss) for each business is the amount on line H minus line I.

For more information about filing returns for deceased persons, see our guide T4011, *Preparing Returns for Deceased Persons*.

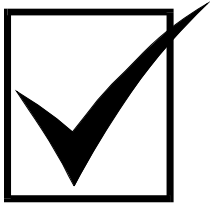
Election

If you completed Part 2, you **have to** sign and date your election on the prescribed Form T1139 unless you already made this election. However, an election for a partnership is valid if it is made for all the partners of the partnership by a partner who has authority to act for the partnership. If you are a partner of a partnership, all the partners of the partnership have to complete this form and include it with their income tax returns.

If you started your business in 2006 and your first fiscal period ends in 2007, you have to file an election with your 2007 income tax return. You can revoke your election at any time and change your fiscal period end to December 31 of the year in which you file the revocation. However, once you change your fiscal period end to December 31, you cannot change back.

Your opinion counts!

We review our income tax guides and pamphlets each year. If you have any comments or suggestions to help us improve our publications, we would like to hear from you!



Please send your comments to:

**Taxpayer Services Directorate
Canada Revenue Agency
750 Heron Road
Ottawa ON K1A 0L5**