

The Berris Mangan Review



SEPTEMBER 2010

Managing Cash Flow in Uncertain Times

By Christopher Dyck, Principal, CGA



In today's economic environment, it is even more crucial to maintain a steady flow of cash into a business. A business is only as successful as the cash it can generate. Generating a steady cash flow begins with selecting quality clients to work with and maintaining open communication throughout the process.

PROJECT MANAGEMENT

Once you have a project from a quality client, the next step is managing the job from the early planning stages to completion. Like most business dealings, it's all about good communication.

1: Avoid "Scope Creep"

"Scope creep" can be defined as the subtle addition of small tasks that are outside the scope of the original contract. It is good practise to communicate with clients if scope creep begins to cause additional time once you commence the work. Obtaining the client's approval of the additional work will avoid billing problems in the future.

2. Issue Regular Invoices

In order to maintain a healthy cash flow invoices should be issued on a monthly basis ensuing receivables are properly managed.

MANAGING RECEIVABLES

Fee disputes are sometimes met with silence from your clients. The invoice slowly moves into the over 90 day category, then 120 day and further. Receivables can be managed by regular communication and reminders.

1. Communication

Clients should be contacted prior to issuing the invoice to advise them of an increased fee or any issue that might be disputed. This allows the client the opportunity to raise their concerns and settle the matter up front.

2. Regular Reminders

As a general practice, a statement of account should be sent to clients for invoices overdue 30-60 days. For invoices older than 60 days, accounts receivable should follow-up with a phone call. Lastly, after 90 days, it may be helpful for the project manager to follow-up with the client.

Christopher Dyck, CGA is a principal with Berris Mangan, Chartered Accountants. He specializes in providing auditing and accounting services to engineering and architectural firms. He can be contacted at (604) 676-5924 or email cdyck@berrismangan.com.

In this Newsletter

Managing Cash Flow in
Uncertain Times pg 1

Asset Sheltering
Check-up pg 2

Selected Tax Implications of
U.S. Real Estate Ownership
by Canadians pg 4

Accounting Standards for
Private Enterprises pg 6

Introduction of HST pg 9



Asset Sheltering Check-up

By Greg J. Gehlen of Gehlen Dabbs, Barristers & Solicitors



Business owners face business risks. Whether it's a contract gone wrong, a non-paying customer or a bad investment, the possibility of financial disaster goes hand-in-hand with being in business, and today's uncertain economic environment makes those risks even harder to ignore.

Although business risks cannot be avoided entirely, the consequences of those risks can be reduced through careful planning. A number of techniques exist to shelter assets from the claims of creditors, three of which are reviewed here.

INCORPORATION

Incorporation of the business provides the owner of the business with protection from general business obligations such as trade payables. In the event of a business failure, creditor claims are limited to the assets of the corporation, not the assets of the owner personally.

As part of this strategy, investment assets should not be held in the operating company, and profits should be removed on a regular basis (eg. by dividends or bonuses). Even the operating assets can be kept from harm's way by owning them in a holding company, which then leases these assets to the operating company. In the event of a claim against the operating company, these assets would not be available to its creditors since these assets are not owned by the operating company.

DIVESTING ASSETS

Not all business risks can be avoided by incorporation. For professionals like accountants, doctors and lawyers, personal liability for negligence is part of the privilege of being a professional. In other cases, a business owner faces personal liability because of guarantees of the business' debts, or because personal liability is imposed on directors of the company by legislation (for income tax source deductions, for example).

For these reasons, non-business assets such as the family home should not be owned by the principal of the business directly, but instead should be owned by some other party such as a spouse, or a family trust. By divesting assets in this way, it is less likely that non-business assets will become subject to business claims. Ownership through trusts can also provide additional benefits such as estate planning.

“Although business risks cannot be avoided entirely, the consequences of those risks can be reduced through careful planning.”

EXEMPT ASSETS

Some types of property are exempt from creditor claims, and holding your wealth in such assets can preserve this wealth in the event of financial disaster. With recent changes to both provincial and federal laws, the most important exempt assets are now RRSPs, along with RIFFs (Registered Retirement Income Funds) and DPSPs (Deferred Profit Sharing Plans).



This exemption for RRSPs is unlimited as to amount, so hundreds of thousands of dollars may be protected from creditors in this way. The exemption does have one exception: amounts contributed in the previous year are not protected from creditors.

THE FINE PRINT

It is important to note that each of these techniques can in the wrong circumstances be attacked by creditors. For example, transferring your home out of your name into the name of your spouse, in the face of a significant creditor claim against you, would very likely be open to attack as a fraudulent transaction.

The key is to put asset-sheltering plans in place before you need them. Waiting until financial calamity strikes will usually be too late.

Intention is also an important element in attacking asset-sheltering transactions. It is always preferable that such transactions have another personal or business purpose, such as tax reduction or estate planning, in addition to their asset-sheltering benefit.

Any asset-sheltering plans must be reviewed carefully on a case-by-case basis. If properly implemented, such strategies can provide a measure of protection against the consequences of business risk.

Greg Gehlen is a partner at Gehlen Dabbs, Barristers & Solicitors where his practice focuses on insolvency matters including business restructuring, bankruptcy and receivership, commercial leasing, lending and security recovery, creditor protection strategies and related matters.

He is a member of a number of insolvency groups, including the Canadian Insolvency Foundation and the International Association of Insolvency Practitioners, and is currently Chair of the Insolvency Discussion Group, a forum of accountants and lawyers practising in the area of insolvency.

*Greg lives on the North Shore of Vancouver, where he still occasionally does the Grouse Grind even though his wife Monika is faster. Reach Greg at **604.642.6401** or email **gg@gdlaw.ca**.*



Selected Tax Implications of U.S. Real Estate Ownership by Canadians

By Brent Axworthy, Partner, CA



Depressed real estate prices in many sunbelt regions of the U.S. have recently resulted in many Canadian residents becoming interested in the purchase of residential real properties in these areas. The obvious appeal of low price and attractive location should be balanced with an understanding of the various U.S. and Canadian tax implications of such a purchase.

Ownership by a Canadian resident of a U.S. real property which is used strictly for personal purposes, and which generates no revenue, will generally not result in an income tax reporting obligation or liability in the U.S. or Canada during the ownership period.

A U.S. real property that generates rental revenue will in most cases result in tax reporting obligations in both countries. Certain steps must be taken for U.S. tax reporting purposes to ensure that tax is applied based on net rental profit or loss rather than gross revenue.

A sale of the U.S. real property will result in tax reporting obligations in both countries, regardless of the use of the property. U.S. withholding taxes may apply. A taxable capital gain may arise on sale if the property has increased in value. Generally, double taxation will not arise, as the U.S. has the priority claim to income taxes on a capital gain arising on sale of U.S. real property, and the Canadian tax liability will generally be reduced by the amount of U.S. income tax paid.

U.S. ESTATE TAXES

The U.S. imposes an estate tax which is applied to the value of certain U.S. situs assets, including U.S. real estate held at the date of death by a Canadian resident. The legislative status of this tax remains in a state of uncertainty, having been phased out for the 2010 year, but expected to be reinstated for the 2011 year with a top rate of 55%. The U.S. estate tax may result in double taxation in some situations. With proper planning such double taxation may be reduced or eliminated, including the claiming of certain tax credits against Canadian income tax in the year of death permitted under the Canada-U.S. Tax Convention.

Canadian residents with relatively small worldwide estates may be able to avoid U.S. estate tax if certain dollar thresholds applying under U.S. domestic tax law and the provisions of the Canada-U.S. Tax Convention are not exceeded. Generally, for the 2011 year, it is expected that the estate of a Canadian resident with a worldwide value of less than U.S. \$1,000,000 should normally be able to avoid a U.S. estate tax liability, but may still have a tax reporting obligation. Joint ownership of a U.S. real property with a spouse raises additional technical issues regarding the estate tax obligations of each spouse including the estate tax consequences of the death of one spouse.



TAX PLANNING

There are various strategies that are employed by Canadians in order to minimize the application of U.S. estate tax in respect to U.S. real estate. Financing of the property using a “non-recourse” mortgage may be helpful. Until recently, a common approach was the ownership of U.S. real estate by a Canadian corporation owning no other assets. A revised position of the Canada Revenue Agency stating that personal use of such a corporately owned asset represents a taxable benefit to the shareholder has resulted in that approach falling out of favour.

Likely the most commonly used alternative structure designed to minimize U.S. estate tax in respect to ownership of U.S. real estate is ownership by one or more Canadian resident trusts. Great care must be taken in the drafting of the terms of such trusts in order to achieve the desired tax results both in the U.S. and Canada. The use of trust ownership is most effective when established at the time of purchase of the property. Other ownership structures such as the use of a limited partnership may be possible.

In addition to U.S. federal income and estate taxes which are administered by the Internal Revenue Service, some U.S. States also impose such taxes, which must be considered in connection with tax planning.

These comments represent only an overview of some of the tax issues that a prospective Canadian resident purchaser of U.S. real estate should consider before buying, regardless of the intended use of the property. While such complications need not discourage a Canadian from making an investment that may be rewarding from a financial and lifestyle perspective, it is critical that competent cross-border tax and legal advice is sought so that the purchase decision is made on an informed basis.

Brent Axworthy is a Partner at Berris Mangan, Chartered Accountants. He specializes in providing tax and related services to private and public clients involved in cross border and international commerce, including Canadians operating businesses and investing abroad, and non-residents and foreign nationals investing, carrying on business, or residing in Canada.

Brent may be contacted at (604) 676-5917 or email baxworthy@berrismangan.com.



Accounting Standards for Private Enterprises

By Craig Whyte, Director, CA



On December 15, 2009, Accounting Standards for Private Enterprises (ASPE) were published by the Accounting Standards Board of Canada. This is a significant change in the accounting standards to be applied in Canada.

These standards will be effective on January 1, 2011 (although early adoption is permitted) and were created as an alternative for those private enterprises that are not required to implement IFRS.

WHO'S IMPACTED?

Basically, most owner managed businesses will qualify to use ASPE. Private enterprises which are not considered publicly accountable enterprises are able to apply these standards.

These are defined as any profit oriented enterprise that: (1) has not issued or is not in the process of issuing equity or debt in a public market or (2) does not hold assets in a fiduciary capacity to the broad group of outsiders will be able to apply these standards.

Examples of companies that do not qualify as private enterprises include public companies, credit unions, insurance companies and mutual funds. Not-for-profit organizations also do not qualify to apply these new standards and will be addressed with a separate set of standards to be introduced in 2010.

WHAT'S THE IMPACT?

ASPE will typically result in simplified accounting treatment and fewer disclosure requirements as compared to the current accounting standards. The following are items that are significantly impacted by these new standards:

1) Financial instruments

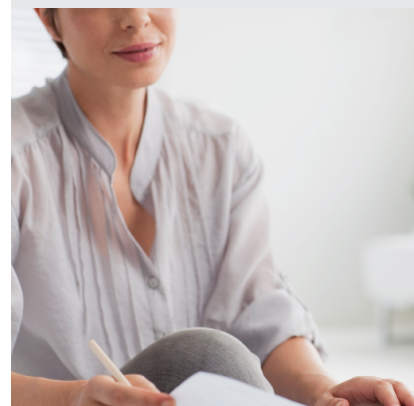
All financial instruments are to be accounted for at cost (or amortized cost) unless they consist of investments in marketable securities that have a quoted market value or free standing derivative instruments which are to be measured at fair value. There is still a fair value option although all gains and losses will flow through the income statement because the concept of other comprehensive income will no longer exist.

2) Embedded derivatives

Embedded derivatives in non-financial contracts will no longer be accounted for as financial instruments therefore there is no requirement to separate and value them.

3) Impairment of financial instruments

A single impairment process will apply to all financial assets. Impairment write-downs are to be based on the difference between the current carrying value and the highest value that the entity could receive under favorable circumstances.



4) Hedge Accounting

Hedge accounting will only be applied when the critical terms of the hedged components match. Periodic effectiveness testing will no longer be required.

5) Retractable Preferred Shares as Part of a Tax Planning Arrangement

These tax planning arrangements will be classified as equity until the holder requires the redemption of these shares.

6) Employee Future Benefits

A funding valuation is permitted to be used to account for a defined benefit plan as opposed to a separate valuation for accounting. If this option is selected, all expenses are to be recognized during the year that they occur. Entities will still be able to account for pension plans under the current accounting policies, if desired.

7) Asset Retirement Obligation

The measurement of asset retirement obligations has been simplified. The obligation will be recognized when a reasonable estimate can be made by management and measured based on management's best estimate.

8) Goodwill Impairment Testing

Goodwill impairment testing will be performed only when there are indicators of impairment. Therefore, there will no longer be a requirement for annual impairment testing of goodwill.

9) Stock-based Compensation

The accounting for stock-based compensation will remain as a compensation expense. The minimum value method will no longer be permitted to calculate the value of stock-based compensation. The calculation of the value of stock-based compensation has been simplified because the volatility of the underlying stock can be estimated using an industry index or a broad index if no suitable industry index can be identified.

10) Future Income Taxes

Either the taxes payable or future income tax method is permitted to be applied to account for income taxes. If an entity uses the taxes payable method then no future income taxes are recognized although there are still certain disclosure requirements.

11) Subsidiaries, Affiliates and Joint Ventures

Entities will be permitted to account for subsidiaries, affiliates and joint ventures using either the consolidation, equity or cost method. The selected method must be applied consistently to all subsidiaries, affiliates and joint ventures.



FIRST-TIME ADOPTION CONSIDERATIONS

Although the effective date for the new standards are January 1, 2011, comparative figures will need to be presented on a similar basis. The general rule is retroactive restatement of changes in accounting policies which means the comparative information is impacted. Certain assets and liabilities may need to be re-valued as at the transition date. There are specific rules to facilitate first-time adoption including the option to fair value an item of property, plant and equipment at the transition date and to treat this as its deemed cost. Also, the standards allow an organization to elect prospective accounting treatment for certain accounts to reduce the cost of changeover.

OTHER CONSIDERATIONS

Even if your organization is not a publicly accountable enterprise and qualifies to apply ASPE, you may still choose to apply IFRS depending on the circumstances. Companies contemplating a public offering or a purchase by a public company may choose to report based on IFRS to facilitate these future transactions. Also, some companies may have significant stakeholders, such as a lender, in a foreign jurisdiction which requires or will require IFRS reporting.

CONCLUSION

The accounting environment in Canada is changing significantly over the next several years and it's important to understand how the changes will impact your organization. As with any significant change, there is a need to plan ahead in order to understand your options and make the right decisions.

Overall, this new standard should reduce the complexity of the accounting and the amount of required disclosures.

Craig Whyte, is a Director at Berris Mangan, Chartered Accountants. *He can be contacted at (604) 676 5920 or email cwhyte@berrismangan.com.*



INTRODUCTION OF HARMONIZED SALES TAX (HST)

By Jamie Nguyen, Senior Tax Accountant, CA

On July 23, 2009, the B.C. Ministry of Finance proposed a harmonized sales tax (HST) for B.C., effective July 1, 2010. The HST rate of 12% effectively combines the 7% provincial sales tax (PST) and the 5% federal goods and services tax (GST).

We have outlined some of the significant topics surrounding the implementation of the HST.

1. KEY DATES IN B.C.

- **July 1, 2010** – HST Implementation Date.
- **October 14, 2009** – HST on amounts due or paid by certain businesses and public service bodies after this date and before May 1, 2010.
- **November 18, 2009** – Transitional rules for residential housing, including grandparenting of written agreements on or prior to this date.
- **May 1, 2010** – HST on amounts due or paid on or after this date for property/services to be provided on or after July 1, 2010.
- **July 23, 2010** – Final PST returns due with BC Ministry of Finance.
- **January 23, 2011** – Final supplemental PST returns due with BC Ministry of Finance.

2. TRANSITIONAL RULES

We have outlined some of the transitional rules for the HST that are proposed in the federal Excise Tax Act (ETA).

Tangible Personal Property

The HST generally applies to any consideration that becomes due, or is paid without having become due, on or after May 1, 2010 for a supply by way of sale of tangible personal property to the extent that the consideration is for tangible personal property that is delivered, and for which ownership is transferred, to the recipient of the supply on or after July 1, 2010.

Services

The HST generally applies to any consideration that becomes due, or is paid without having become due, on or after May 1, 2010, for a supply of a service, to the extent that the consideration relates to the portion of the service performed on or after July 1, 2010.

If 90% or more of the service is performed before July 2010, no HST would be payable on the consideration for the service.

Lease of Tangible Personal Property

HST will apply to the part of the lease interval that occurs after June 30, 2010 unless the lease interval begins before July 2010 and ends before July 31, 2010, in which case GST and PST, where applicable, will apply.



Intangible Personal Property (IPP)

HST generally applies to consideration that becomes due, or is paid without becoming due, on or after July 1, 2010 for a supply of IPP (eg. intellectual property, contractual rights) by way of sale.

Commercial Real Property

HST generally applies to a supply of real property (other than used residential housing) by way of sale if both ownership and possession of the property are transferred to the purchaser on or after July 1, 2010.

3. PLACE OF SUPPLY RULES

Place of supply rules determine the province in which a supply is deemed to be made for purposes of determining which tax rate GST/HST registrants should charge.

We have outlined some of the proposed changes to the place of supply rules that were announced by the Department of Finance on February 25, 2010.

Supplies of Real Property

No changes are proposed to the current place of supply rules for real property. Supply is generally made in the province in which the real property is located.

Supplies of Tangible Personal Property

No significant changes are proposed to the current place of supply rules for tangible personal property. Generally, supply is deemed to be made in the province which the goods are delivered or made available to the recipient.

Supplies of Intangible Personal Property

Changes are proposed to the current place of supply rules for IPP; specifically, there will be less emphasis on the place of negotiation.

Supplies of IPP that can be used in Canada but are restricted to use primarily (ie. more than 50%) within a participating province will be deemed to be made in the participating province and subject to HST.

If a greater proportion cannot be determined, certain sequential rules must be applied to determine the place of supply.

Supplies of Service

Under the proposed rules for services, the supplier's location represented by the place of negotiation will no longer be a criterion in determining the place of supply. Instead, greater emphasis will be placed on the location of the recipient.

Generally, for services for which the supplier obtains an address of the recipient, this will determine the place of supply of the services. If no address is obtained in the normal course of the supplier's business, place of supply will typically be based on location of where services are performed.

Similar to supplies of IPP, certain sequential rules must be applied to determine the place of supply.

4. RECAPTURE OF INPUT TAX CREDITS (RITC)

During the initial period of the HST in B.C., it is proposed that a large business be required to repay or 'recapture' ITCs (RITC) attributable to the provincial component of HST that becomes



payable in respect of “specified property and services” acquired, or brought into B.C., by the large business for use by that business in the province. This will effectively prevent a business from claiming an ITC on the provincial component of the HST (ie. 7%) on certain transactions.

“Specified property or service” generally means a road vehicle, energy, a telecommunication service, or a meal or entertainment that is acquired, or brought into British Columbia, by a large business for use by that business in the province.

The RITC requirement will apply to large corporations and their associated corporations (ie. those making combined taxable supplies worth more than \$10 million annually, and certain financial institutions).

The rate of ITC recapture would be 100% for the first five years that the HST is in effect in B.C. The RITC requirement would then be phased-out by reducing the rate of recapture in equal increments over the following three years. Thus, the ITC recapture rates would be:

- 100% for the period from July 1, 2010 to June 30, 2015;
- 75% for the period from July 1, 2015 to June 30, 2016;
- 50% for the period from July 1, 2016 to June 30, 2017;
- 25% for the period from July 1, 2017 to June 30, 2018; and
- 0% on or after July 1, 2018.

5. HOUSING RULES

We have outlined some of the general housing rules that will apply as a result of the HST implementation:

- HST of 12% generally applies to a taxable sale by a builder of newly constructed or substantially renovated housing where both ownership and possession of the housing are transferred to the purchaser, under the agreement for the sale, after June 2010.
- For new homes priced up to \$525,000, a proposed enhanced rebate ensures that an individual bears no additional tax than under the previous GST/PST system. The proposed enhanced rebate is available for newly constructed or substantially renovated homes purchased as primary residences. The rebate will be equal to 71.43% of the provincial component of the HST (ie. 7%), up to a maximum of \$26,250. An individual will be able to claim both the proposed enhanced rebate and the current GST new housing rebate. A similar rebate is also available for new rental housing and is not restricted to individuals.
- Under proposed changes, a PST transitional new housing rebate may be available for certain newly constructed or substantially renovated housing where the construction or substantial renovation of the housing is at least 10% complete as of July 1, 2010.
- Under proposed changes, builders may have to account for a transitional tax adjustment of up to 2% of the sale price.

If you have any questions regarding HST, Jamie can be reached at (604) 682-8492 or jnguyen@berrismangan.com.

Contact Us

Berris Mangan, Chartered Accountants

1827 West 5th Avenue
Vancouver, BC V6J 1P5

Office Hours
8:30 a.m. to 5:00 p.m.
Monday through Friday

Tel: 604.682.8492
Fax: 604.683.4782
Toll-free: 1.866.682.8492
contact@berrismangan.com

Visit our website:
www.berrismangan.com

Disclaimer: This is not advice. Clients should not act solely on the basis of the material contained in this document. Items herein are general comments only and do not constitute or convey advice per se. We therefore recommend that formal advice be sought before action in any of the areas. This document is issued as a useful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our written prior approval.