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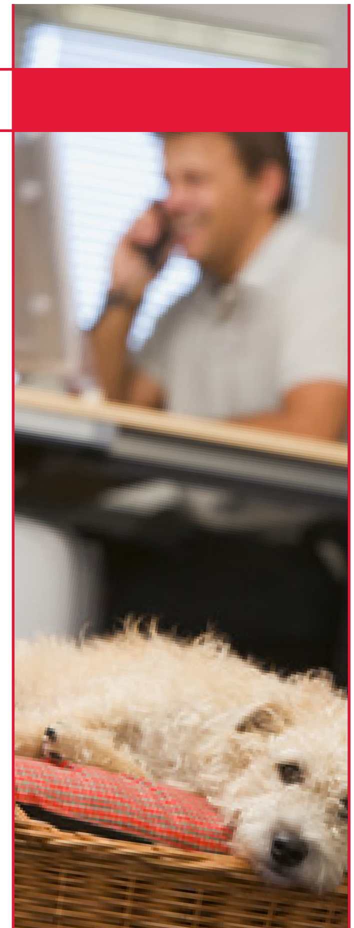

Business Matters

TAXATION

The Benefits of Self-employment

Self-employment can be the start of something great but there may be a price.

To people who are conventionally employed, the world of self-employment often looks enviable. This is not too surprising since there are very few deductions from income available to anyone working for a salary or hourly wages. So, for those who work for others, it is difficult not to covet the deductions from income available to the self-employed as a major advantage of *being* self-employed.

If you are considering the option of self-employment, it is important to understand some of the myths and truths.

Self-employment Myths and Truths

100 Percent Deduction
At first blush the ability to deduct from revenue expenses incurred to produce business income is a positive feature. After all the self-employed save "lots of money" because they can deduct 100 per cent of purchases, office supplies, computers and vehicle expenses. However the belief that the self-employed are able to deduct 100 per cent of their expenses is a myth because it does not consider the following:

1. In order to deduct the purchase, the expenditure must have been made to earn income.

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2. Although the $100 item is offset against the $1,000 revenue, the effect of the deduction on the self-employed person's taxes is not $100 but an amount determined by the self-employed person's marginal tax rate. Thus, if the self-employed person's tax rate is 23 per cent, the actual savings is only 23 per cent of the $100 expenditure, or $23.

3. The self-employed individual must earn sufficient income to have something against which to deduct the expenses in the first place. Thus, if a self-employed individual incurs expenses that result in a business loss but has no other sources of income in that year, there is no benefit from a tax viewpoint in the year of the loss. However, the loss can be carried back three years or forward twenty years to offset income earned in any of those years.

Self-employed individuals are not required to pay EI premiums.

Show Me the Money!

Employment Insurance

The arm's length employer is required to deduct Employment Insurance premiums from an employee's remuneration for remittance to the CRA. These contributions amount to 1.73 per cent (1.36 per cent for Quebec) of the first $43,200 in gross wages in 2010, to a maximum annual amount of $747.36 ($587.52 for Quebec). The employer is also required to remit an amount calculated as a percentage of the employee's share. The employer is assessed 1.4 times this amount to a maximum of $1,046.30 ($822.53 for Quebec) in 2010. The total contribution to the EI program is $1,793.66 ($1,410.05 for Quebec).

Self-employed individuals are not required to pay EI premiums. Thus, the self-employed individual who has taxable income equivalent to $43,200 would not remit an amount equivalent to the employee and employer share. This may be seen as an advantage. However, the downside to "saving the deduction" is that the self-employed individual cannot claim EI benefits if the business fails.

It is often difficult to determine whether spouses and other closely related family members are eligible to claim EI if they work for the self-employed individual — even if they work side by side with an non-related individual doing the exact same work for the exact same pay. Sections 52 (i) and 52 (b) of the Employment Act suggest that if a relative is performing a task substantially similar to that performed by an unrelated employee, he or she may be able to pay into the EI program and receive employment benefits. Notwithstanding these rules, employers should obtain a ruling on the relative from the Canada Revenue Agency. Application and review are usually conducted by the nearest taxation office and a ruling provided within 60 days. Owner/managers who hire relatives should consider paying the EI premium to demonstrate they are following employer regulations. Should the ruling state that the employee is ineligible the premiums will be refunded.

Canada Pension Plan

CPP deductions remitted by the employer to the CRA are for Canada Pension benefits to be received by the employee at the government-mandated retirement age. The employee portion of the remittance is 4.95 per cent of gross wages in excess of a basic exemption of $3,500, up to a maximum gross wage of $47,200 in 2010. This amounts to $2,163.15 per annum. The employer is required to match this contribution, thus bringing the maximum combined contribution of employee and employer up to a total of $4,326.30 in 2010.

The self-employed individual is required to pay CPP in the same percentage as the employed individual plus the equivalent share as if the self-employed person were his own employer. Therefore, the self-employed individual is required to pay both sides (the employer *and* the employee portions) or $4,326.30 into CPP, in 2010. (A federal non-refundable tax credit of 15 per cent provides marginal relief on $2,163.15 of contribution. Different rules apply in Quebec, which includes QPP in its basic personal amount for which it provides a 20 per cent credit in 2010.) The self-employed individual, after having made twice the contribution of the employee who works for someone else, nevertheless receives only the same amount of Canada Pension when retirement time comes around.

The self-employed individual does not have to remit withheld income tax on a regularly scheduled basis.

Income Tax

The self-employed individual does not have to remit withheld income tax on a regularly scheduled basis as do the employed. However, if the self-employed person does not voluntarily make installment payments against his or her estimated tax liability for the year, the CRA assesses interest when income tax is ultimately determined to be owing.

Employees do not have the opportunity to split employment income with their spouses unless the contract of employment requires the employee to pay an assistant or substitute and the spouse can perform this function. Thus, an employee may be taxed at a higher rate than a self-employed person.

Self-employed individuals with spouses and children of working age can hire family members and reduce the overall income attributable to themselves. Although this may have the immediate effect of reducing the self-employed person's current income tax liabilities, it will reduce CPP and RRSP contribution levels and thus negatively affect the growth of retirement savings.

Other Fringe Benefits

Many employees receive non-taxable benefits such as dental, health and life insurance not available to the self-employed. These benefits can amount to a substantial percentage of total remuneration. Self-employed individuals must pay for these benefits themselves, usually at a much higher cost especially if they cannot be covered under a group plan.

Employment law requires that an employee receive vacation time or the equivalent in remuneration. Employees are usually granted sick time, normally receive pay even when absent, and are not usually dismissed because of illness. Self-employed individuals do not have this luxury: failure to complete a project on time can mean lost future work while a day off work because of illness is a day's income lost.

The lack of benefits means the self-employed must purchase their own health or disability insurance to cover any down time. This insurance is often extremely expensive and limited in coverage.

Employed workers do not have to pay for liability insurance nor are they responsible for payroll source deductions and the numerous other taxes such as GST/HST/PST/WSIB. All these costs and their related reporting requirements are entirely the responsibility of the self-employed.

Self-employment is Not Just about Deductions

Self-employment does offer benefits not accessible by the employed individual. However, it is also true that employees receive benefits that are not available to the self-employed without substantial cost. Some of these benefits, as demonstrated, are financial and may reduce the tax liability; other benefits are considerably more abstract.

Freedom from the restraints of a 9-to-5 cycle, freedom from "office politics" or the need to report to one perhaps unpleasant individual, plus the choice to work as little or as much as one wants are reasons often put forth by the self-employed as benefits of their chosen way of earning a living. Employment or self-employment . . . the choice is yours.

TECHNOLOGY

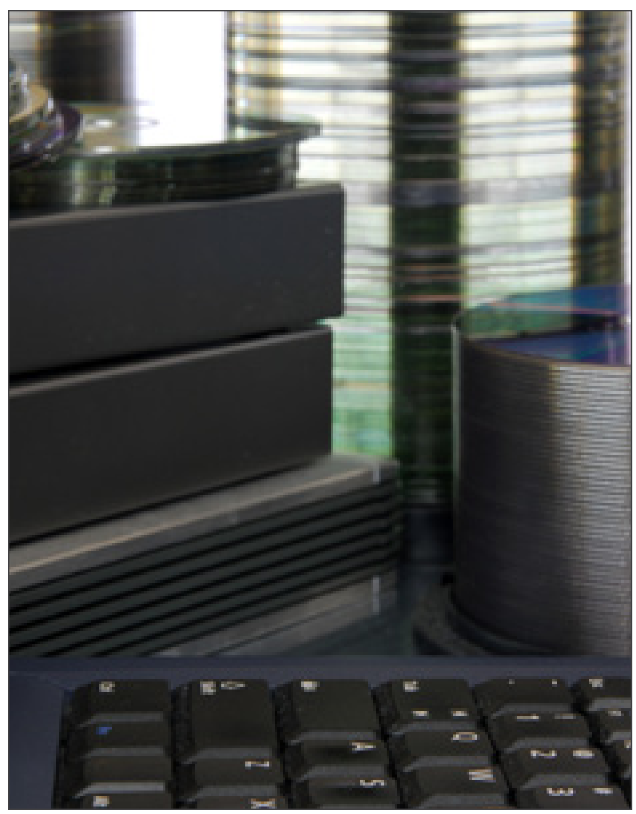
Easy Transfer

Get ready for Windows 7. *Windows Easy Transfer* makes moving files and folders easy.

Sooner or later you will have to replace your computer. One of the biggest inconveniences of getting a new machine is moving all your files onto the new computer. Windows 7, which now comes preinstalled on most new computers, includes a utility called *Windows Easy Transfer* that helps you do just that.

Easy Transfer will copy most files and folders, including documents, photos, music, videos, Internet favourites, email and contact information. It will also copy user accounts and program settings, but does not copy or install any applications. Thus, it will be necessary to find and reload the original program discs.

(If further assistance is required, Microsoft's website, along with numerous others, provides in-depth instructions and tutorials aimed at assisting in the transfer of data from Vista and XP to Windows.)



To make the transfer easier users should:

1. **Review the software on the old computer.** Determine what software is essential to operations and locate the original discs and activation codes. To continue using some older applications, check with the vendors to make sure your version is compatible with the new operating system.

2. **Review what data needs to be transferred.** Determine where the data is stored and ensure the files you need are selected in the transfer wizard. Regardless of how organized your hard drive is, rogue files can get into the wrong folder. Document the files to be transferred and check them off as they are transferred.

3. **Ensure you have a copy of any software keys.** If you purchase and download any software via the Internet, keep a copy of the installer as well.

4. **Back up all essential data files.** Back up files onto a portable hard drive before starting the transfer. This will ensure original source documents are maintained and accessible.

5. **Download *Windows Easy Transfer for Windows XP*.** If your old computer is running Windows XP, you will need to download *Windows Easy Transfer for Windows XP* from Microsoft's website. Microsoft will authenticate your Windows XP installation to make sure it is genuine.

6. **Upgrade with Service Pack 1 or 2**. Computers using Windows Vista should upgrade with Service Pack 1 or 2.

7. **Check the type of processor used by your new and old computers**. Note that *Easy Transfer* does not support the transfer of data from a 64-bit machine to a 32-bit machine.

8. **Determine the method of transferring files**. *Easy Transfer* allows transfer of data by various means and to various mediums. Depending upon your hardware and communication ability, one of the following means may be used:
   - A special USB cable available from your local computer store is designed to work with the *Windows Easy Transfer* program.
   - If your business has a wired or wireless network, the data can be transferred directly over the network connection. Since wired connections are significantly faster than wireless, you may wish to connect both computers to the wired network before you begin.
   - An external hard drive can be used, and is a good way of transferring large amounts of data from one computer to another.
   - For smaller amounts of data, a USB flash device or rewritable CD or DVD may be used.

Easy Copy

Whenever files are transferred from one medium to another there can be some trepidation that the source data may be affected. It is important to note that *Windows Easy Transfer* does not modify or delete any of the settings or data stored on the old computer; it simply makes a copy. If the transfer process is interrupted for some reason such as a power failure, it is simply a matter of starting a new transfer process with the unaltered original data.

Easy Transfer will copy most files and folders.

You Asked

Q: I have a "really really" old computer that does not physically support the newer peripheral devices. Can I use *Easy Transfer*?

A: Most computers capable of running Windows XP should support at least one of the transfer options. *Windows Easy Transfer* does not support the parallel, serial cable and floppy disc transfer methods that were included in previous versions of Windows. New computers typically do not have the physical capability of supporting these older data standards, nor are those methods capable of transferring large amounts of data in a reasonable amount of time.

Support

Microsoft's website along with numerous others provides in-depth instructions and tutorials aimed at assisting in the transfer of data from Vista and XP to Windows. Most users would benefit from reviewing the site and following the process.

Start Planning Now

Regardless of how closely one follows instructions there will be areas you will have to fix yourself. Reloading applications, contacting the original vendor to determine whether they will permit another download to a new computer, or discovering the new operating system will not support the older operating programs are areas that will take away from productive time and the bottom line.

Combine these factors with the inevitable learning curve required for all staff to get up to speed with the new operating system and you can see that now is the time to start budgeting time, money and staff resources to convert all computers and software to Windows 7.

MONEYSAVER

Fighting Heavy-equipment Theft

Installing tracking devices on heavy equipment can shorten recovery time after a theft and reduce losses caused by down time.

Priceless

Loss of utility trailer $7,000; disappearance of power tools $6,000; missing front-end loader $35,000; lost income $12,000; . . . . Arrest of thieves and recovery of assets . . . **PRICELESS**.

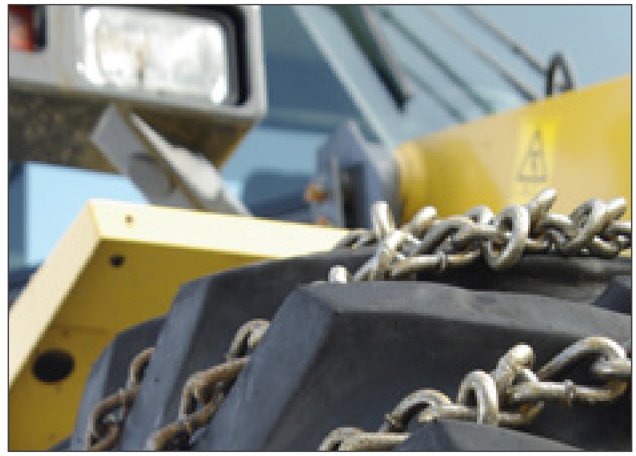
Since 2005 heavy-equipment theft in Ontario has risen from an estimated $15-$20 million per year to about $31 million in 2009, according to George Kleinsteiber, equipment-theft consultant to the Ontario Sewer and Watermain Construction Association. Across Canada, however, theft seems to be down slightly when measured by the number and value of the units stolen. According to Mr. Kleinsteiber, most equipment is recovered within a 100 km. radius of where it was stolen; other equipment, especially high-value earth-moving vehicles, is often shipped to Russia, Nigeria and elsewhere overseas.

Theft Risk Equals High Insurance Premiums

Small business owner/managers are often victims of theft because they cannot afford to build warehouses or security fences and have to store equipment overnight at offsite locations or at the construction site itself. The equipment stolen may be underinsured because the replacement value far exceeds the claim settlement paid by the insurer after accounting for depreciation. Once a claim is made the likelihood of increased insurance premiums or even coverage cancellation are real possibilities. Given that most equipment is financed, it is likely that cash flow will suffer since most or even all of the claim settlement will have to go to the lender and little will be left to purchase new equipment. Of course, claims must be filed with the insurance company to replace lost income and the value of insured assets; however, the physical recovery of the assets themselves and the resumption of operations may provide more financial advantage for the owner/manager.

Protection Options

Devices that reduce theft through ignition immobilization are useful but equipment and vehicles can often be towed or loaded onto transporters and driven away. Stopping theft entirely is impossible, but contractors can increase the likelihood of recovery within hours with the new-age asset security companies.



Tracking Equals Early Recovery

Many security systems now combine the Internet with global positioning satellites and cell-phone technology to track an asset to within nine meters of its location. A wireless transmitter hidden inside the equipment transmits its location anywhere in North America. The cell-phone approach purportedly allows more effective tracking because it relies on cell towers to pick up signals versus the GPS approach that requires sightline access to satellites. The consumer will define requirements based upon physical location of assets, and satellite versus cell-phone communication ability. Caterpillar announced in April 2009 that it was now installing an equipment tracking and management system in all new core machines manufactured in North America.

Most equipment is recovered within a 100 km. radius of where it was stolen.

Asset-security Factors to Consider

As with any product or service the cost will depend upon the level of security desired. When looking into managing asset security consider the following:

1. Does the system provide tracking anywhere in North America?
2. Does the system combine wireless capability with the ability to connect via wireless networks and the Internet?
3. Does the system locate equipment on a map on demand by simply using the Internet?
4. Will the system notify a support centre that it requires maintenance?
5. Can the system establish an operational territory beyond which the equipment cannot go without transmitting a notification?
6. Can the starter be disabled in the event the equipment is used without authorization?
7. Can the system contact an email address or cell phone with a text message that the equipment is on the move?

Will the system permit communication with more than one contact?

8. Can the equipment be tracked via a web browser, PDA or cell phone?
9. Does the security-system supplier guarantee that, if the equipment is not recovered within a specified time, it will reimburse the cost of a new system or that a new system will be installed in new equipment?
10. In the event of equipment movement, does the provider contact the police or is the equipment owner responsible?
11. Are all communications with the equipment secured from outside hackers?
12. Will the equipment insurer reduce the cost of equipment or fleet insurance upon installation of the new security system?

Tracking Systems are Good Value

Prices for moveable equipment tracking programs start at around $500 plus additional yearly service charges. Given the high cost of the equipment being protected and the costs of business interruption insurance, this is a small price. However, the ability to locate stolen equipment combined with the knowledge that downtime may be reduced significantly when recovery time is reduced to hours provides ample reason to consider purchasing security for these very expensive assets.

MANAGEMENT

Managing Employee Performance

Employee turnover is expensive. Managing employee performance means less attrition and happier employees in the long run.

Mutual Benefits

Organizations spend time and money screening applicants to ensure they have the skills listed in the job description. But an employee is much more than a skill set; he or she is also a complex of personal characteristics.

The company wants the skills to carry out the corporate strategy and the employee needs a job that not only provides a living but also brings personal satisfaction. The object of performance-management systems is to create this win/win for both parties.

The Foundation of Performance Management

For a performance-management system to work, certain management practices should be developed with employee input. The exclusively top-down approach is gone. Today's employees want to participate in the decisions that affect their lives. They want fair decisions based on accurate information. The flattening of the corporate structure through job redesign and the removal of so much middle management have made this demand for empowerment inevitable and it should be respected.

Job Analysis Defines Skills, Duties and Responsibilities

Since jobs are defined by their outcomes, the skills needed to achieve those outcomes must be identified. The employee doing the job can often become more efficient if the supervisor is open to discussion and change. This dialogue should include discussion of the output levels required to achieve the corporate strategy. If, for instance, the corporate strategy is to increase market share by five per cent in the next three years, there must be some output level required to achieve that. This output level can be worked back to the output required by the individual employee.

Job Description Explains Skills, Duties and Responsibilities

A formal, written job description derived from the job analysis is essential to any performance-management system. It is a reference document for both employees and supervisors that should contain the standards of performance expected of the employee.

Quantified Performance Expectations

Without the quantification of performance expectations employee productivity cannot be tracked. If, for example, part of the corporate strategy is to reduce overall material wastage by ten per cent this year, the individual employee's performance can be linked to this and measured. The employee's failure to achieve a ten per cent savings in material may be linked to performance or job design.

Support and Coaching of the Employee

Line management is the key function in the performance-management system. Line managers are the sergeants of the business world; they must understand the required job skills and have good communication skills. Coaching goes on throughout the year. Criticism is also part of this dialogue and not something to be saved up for an explosion at the employee's annual review.

Recognize and celebrate good performance.

Recognition and Celebration of Good Performance

Recognize and celebrate good performance. Even if you are starting to think that "employee of the month" and other small awards are kind of corny, think again; employees love them. Many employees have had all too little recognition in their lives and such an award now and again can mean a lot. A special assignment, mention in the house newsletter and even a bit of praise from a superior can go a long way to improving employee morale and reducing attrition.

The Formal Performance Review

The summary performance review is usually held annually but can be more frequent. In the past, it was often done by the line manager, the person with the most first-hand knowledge of the employee's performance. This narrow process has broadened in recent years to include peer, subordinate, team, customer and even self-review.

Peers can be very insightful about one's strengths and weaknesses. Opinions of subordinates are also valuable in assessing the effectiveness of a supervisor. Team members are excellent judges of that combination of skills and tact that reveal the future team leader. Since much of a salesperson's working life takes place beyond the view of any sales manager, the customer becomes an important judge of the salesperson's effectiveness. Finally, self-assessment can reveal personal problems that may be affecting performance.

Criticize the Performance Not the Person

When bringing this 360-degree review together it is important to focus on the performance and not the person. That means looking at the three quantifiable factors that are the principal grounds for dismissal with cause: lateness/absenteeism, performance and behaviour. When the results are presented at the employee interview, anonymity of sources must be ensured to prevent the employee from thinking there is any unfairness or imbalance in the review. When the information is gathered, the respondents must be made to understand what information is required and how the rating system works.

Weaknesses of Performance-management Systems

While sound in principle, a performance-management system can go off the rails at many points. The most common weakness is the failure to link the performance objectives of the individual employee to the quantifiable goals of the company. If individual employee output is not connected to the desired level of company output it is free-floating and arbitrary. When the output figures are not grounded in the company strategy, then corrective training cannot be planned because it too cannot be connected to any quantifiable level of necessary output improvement. Infrequent discussion of individual objectives, haphazard reviews, poor record keeping, lack of feedback from the employee, a culture of "blame" instead of support and mentoring, an aggressive and uncommunicative line manager and many other factors can skew and ultimately render the performance-management system useless.

Training Performance Managers

Training is the key to having an effective performance-management system. Managers need to have precise standards for reviewing employee performance, and the observational and communications skills for analyzing and communicating the results both to their own superiors and in the form of feedback to their subordinates. For the owner/manager wishing to better manage employee performance, the Web under "performance management systems" is a rich guide to both general advice and the software needed to keep records and do statistical analysis.

***BUSINESS MATTERS* is prepared bimonthly by The Canadian Institute of Chartered Accountants for the clients of its members.**

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