Can’t pay your taxes? Face the music right away

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For many small business owners, it’s time for the “annual CRA challenge” – a spring ritual when they receive that unadorned brown envelope from the Canada Revenue Agency with a big, fat tax bill.

“I’m in it right now,” said Bruno Marsala, who owns a video production company. “I managed to get through a $45,000 HST audit, I paid that back and now I have a $40,000 corporate tax bill.”

The owner of Green Screen Studios in Erin, Ont., knows his way around the CRA due to his successful effort to settle his HST obligation. But he understands that for many business owners facing a large tax bill, the first instinct might be to walk away rather than dig deep.

“Do I just close the door on the business, start fresh like everybody else does, declare bankruptcy on the business side?” he said. “It is a corporation, so I’m not technically on the hook for the tax money, but it is difficult.”

He is determined to pay off the corporate tax bill like he did with his HST, using the same mix of stubborn determination and oversharing that worked so well the last time. That is also the most important lesson he has for those facing the CRA challenge: Don’t run and hide.

“I am always on the phone with them,” he explained. “That is the key that has really made them co-operative.”

Mr. Marsala’s challenge, as with other small business owners, is that his cash flow ebbs as much as it flows. This can make budgeting difficult and tempt even the most disciplined to dip into their HST coffers to pay expenses.

It turns out that the 13 per cent Harmonized Sales Tax that Ottawa requires businesses to collect, can lead to surprise tax headaches.

“They always whine about it every year. They don’t pay for it in advance and then they blame the accountant,” said Andrew Patricio, founder of BizLaunch Media Inc., a Toronto-based company that offers training to small businesses.

Mr. Patricio, who has started seven businesses over his career, has a simple solution to the HST trap: He pays his HST bill monthly. “If you speak to the accountant they say, ‘That is stupid, why are you paying the government money in advance?' But I never have that problem" of winding up with a huge tax surprise later.

Aside from paying his taxes, he also pays himself a monthly salary. A surprising number of business owners fail to make this a formal practice, at least in their startup days.

Determined that he will not be faced with another spring tax surprise in the future, Mr. Marsala last fall hired a financial adviser, Renee Verret, a certified financial planner with Money Coaches Canada. "It has been a huge boon to us," he said. Ms. Verret zeroed in on the cash flow from his business, which is the sole source of support for Mr. Marsala's family of five. He faces a balancing act – drawing enough money to support his household without piling up big year-end tax obligations.

"A lot of my clients just draw [money from their businesses]," Ms. Verret said. "Just draw, draw, draw. They don't put aside any of the cash flow or the dividends, and they don't pay any taxes during the year. So when they get that tax bill later, it is huge. Corporate, and then personal."

Ms. Verret's preferred strategy is for her business-owner clients to draw the maximum pensionable earnings (about $53,600 in salary). That allows people to pay off some of their personal tax bill over the year, opens opportunities for deductions and allows them to make CPP contributions.

In the case of Mr. Marsala, Ms. Verret has come up with a mixed strategy where he is collecting a salary and corporate dividends in alternating months.

Paying oneself in dividends can be more tax efficient than drawing a salary, Ms. Verret noted, but business owners often run into end-of-year tax problems because they are not setting aside the roughly 30 per cent in tax obligations. "If they could pay themselves only dividends, from a tax perspective it is better, but they are going to forfeit CPP, they won't have any RRSP contribution and I guarantee you they are not putting the money aside for taxes."

Tips for entrepreneurs
Tax takeaways from certified financial planner Renee Verret, of Money Coaches Canada:

That HST money is not yours, it's Ottawa's: "In some ways I wish there was a better system, like the HST could go directly to the government," Ms. Verret says of the tax that businesses collect and must turn over to Ottawa. "Very few self-employed or incorporated people are fabulous at this. They are fabulous at their service or their product."

Hide the HST piggy bank: Ms. Verret advises her clients to set up a side bank account with a secondary financial institution such as a low-fee bank (Tangerine or PC Financial, for example) to keep HST money out of sight and a bit more difficult to access. “It doesn’t show when you pull up your bank statements.”

Always take Ottawa’s call: Ms. Verret lauds Bruno Marsala, owner of a video production company, as perhaps Canada’s most cheerful taxpayer. She admires his unflinching approach, though she counsels less, not more, for most clients when it comes to dealing with the CRA. “It has worked for him.”