

Catalyst

A topical newsletter for privately held businesses

Fall 2008

'Tis the season to be wary

As winter approaches, Canadian businesses are feeling the chill in more ways than one. The struggling economy seems to have settled in and is worrying owners from coast to coast. And the credit crunch—gone from probability to problem—is raising concerns that banks will give them the cold shoulder on new lending while turning up the heat on outstanding debt.

While there's cause for concern, it's not time to hit the panic button yet. There are strategies you can adopt with the bank to help manage your lending needs and debt concerns, and there are measures businesses can take come tax time to soften the hits they've taken from the flailing economy.

In this issue of Catalyst,

- Tim Rider, Regional Vice President with the Royal Bank of Canada, is interviewed by Grant Thornton LLP professional Hassan Jaffer about the current lending climate and suggests some ways business owners can deal effectively with their banks;

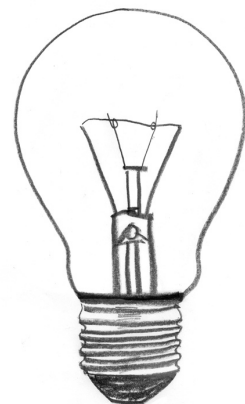
- Grant Thornton tax partner Dan McKinley talks about a few timely tax strategies you may not have thought about that directly address the current economic downturn; and
- we offer a few tax tips specifically designed to help relieve some of the credit crunch pressure.

We know how to deal with a rugged climate in Canada, and the current economic climate is no different. Come in from the cold and enjoy the Fall '08 issue of Catalyst.

Gary Dent
National Tax Leader,
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Lending in the current economy

An interview with RBC's Tim Rider

With no immediate signs of economic recovery in sight, Canadian businesses are wondering, “Where do the banks stand in all this?” Hassan Jaffer, Financial Advisory Services, Grant Thornton, asked Tim Rider, Regional Vice President, Greater Toronto Region, Commercial Banking, Royal Bank of Canada, to offer some inside perspective on lending in the current economy.

Despite the economic downturn and the concerns financial institutions have about granting new loans, is RBC open for business?

Tim: While I cannot speak for all of RBC, I can speak for the commercial segment in Canada, and the answer for the small- and mid-market sectors is absolutely yes—RBC is wide open for business. Canadian entrepreneurs have been absolutely brilliant at dealing with the challenges that have been thrown at them, and RBC is in an excellent position to expand our support for them through this volatile period.

We're bombarded with bad news about the downward spiral of the US economy and its effects on Canadian business. How do you see the future?

Tim: As with all downturns, the energy and creativity of entrepreneurs will lead the economy back. Entrepreneurs always seem to find a way to adjust and move where opportunity takes them. The small- and mid-sized firms have superior capacity for change compared to larger firms with significant infrastructure. The big question that nobody can answer at this point is, how long it will take?

Are you focusing on any industries that are immune to volatile energy and commodity prices and the US/Canadian dollar differential?

Tim: Very few industries are immune to the overall economy and consumer trends. RBC's mid-market portfolio is very well diversified, with great clients, and is currently in good shape. Given these strengths, RBC is looking for the best operators in almost every industry, as these clients know how to manage through even the most difficult of times.

What can our clients do to prepare prior to approaching their bankers for loans? And what do our clients need to know about making a successful loan application?

Tim: Companies need to understand that banks all have various criteria to assess a company's performance, so potential borrowers would be well advised to ask the loan officer what criteria they will be assessed against. That being said, borrowers must always remember that banks look for two sources of repayment: cash-flow from profits, and assets or collateral.

Any loan application needs to include historical results; an up-to-date business plan including a well-articulated SWOT analysis; and projected financial results including profit and loss statements, a cash flow analysis and monthly balance sheets.

While there is certainly a technical aspect to lending, relationship is something that should also be kept in mind. Does the borrower understand the value proposition of the bank in question? Do they have similar ways of doing business? What is the culture of the bank? Who makes up the relationship team from the bank? These are all questions to consider and ask of the bank.

We are in a period of volatility, which causes uncertainty. The relationship between customer and banker is an intangible that might be the difference between a “yes” or a “no”—or more likely the answer to “how much more?”.

When the going gets tough...the smart stop and think about the tax implications.

By Dan McKinley, Tax Services, Grant Thornton

Will I be able to repay my loans? Will my operations remain stable? Am I going to incur losses from which I can't recover? These are just some of the ways nervous Canadian business owners are asking the same basic question: What does the financial future hold for me and my company?

A major economic downturn is no longer looming—it's here. And the credit crunch is squeezing businesses of all sizes, across all sectors. With these pressures bearing steadily down, business owners are looking not only to cut losses, but to recoup wherever possible. This is where creative strategies can come into play. But the Canada Revenue Agency (CRA) is increasingly on guard, and tax-wise, there are as many traps to avoid as there are strategies to consider. Let's look at some key areas you might need to address.

Directors' liability

When the economy's booming and companies are turning a consistent profit, the prestige of holding a directorship is an invariable lure. In an economic downtime, however, there are certain associated risks that many aren't fully aware of. If a business fails, for example, a director of that business may incur liability for such things as unpaid GST or payroll deductions, and this liability can extend up to two years after the directorship is relinquished. Moreover, even if you're not officially a director, you may be considered one if you're determined to have acted in that capacity. And under current income tax

legislation, the CRA can immediately determine liability with no court action required. For all these reasons, it may be a wise tax strategy to assess your situation and determine whether you want to continue to act in this capacity.

Asset protection

Issues may also arise for owners if there has been a transfer of assets between themselves and their corporation. Often, owners will decide to purchase assets from the company—such as real estate or shares in other corporations—in order to prevent their seizure should the company fail, or in payment of a debt owed them by the company. In such cases, the CRA will look closely at whether or not the transfer has been executed at fair market value; if not, you may find that you are subject to tax to the extent the fair market value of the property exceeds its sale price. There can also be legal concerns around the timing of withdrawals and distributions from your company when it's in financial difficulty.

Debt resolution

At the same time as companies are cinching up the purse strings and looking for financial help, banks are becoming more rigorous—extending new loans warily, expanding reviews of existing loans, demanding thorough client asset reviews, and generally exercising more caution and oversight with respect to their lending activities. This is not, however, to say that banks are entirely inflexible, and they do still need to do business and maintain their clientele. So if you have outstanding loans and are increasingly concerned about your ability pay, it can be worthwhile to discuss alternative debt resolution strategies with your bank.

Tips to remember, plans to reconsider

- Assess the benefits of being a director—the liability issues may not be worth it.
- Be up front with the bank—they'll work with you if you keep them in the loop.
- Be careful with debt resolution strategies—know the tax implications before settling.
- Get your financial adviser involved early—a good plan is the best solution.

At this point, trying to hide financial problems from the bank is the biggest mistake you can make. It's crucial to be open and frank. They may well be willing to discuss restructuring your loan repayment options if they feel they're getting full disclosure. You may even consider relinquishing assets to the bank in payment of a debt. But there are issues to consider here as well. A foreclosure, for instance, is essentially treated like a sale for income tax purposes, something many are not aware of when they believe it has simply accomplished the final settlement of a debt. For instance, if you own an asset worth \$60,000 and your bank agrees to acquire it in payment of an \$80,000 debt, your bank may call it even, but the CRA will call it a \$20,000 profit and present you with a bill for taxes owing.

When times are tough, it's crucial to consider measures you can take to avoid placing yourself in an unnecessarily vulnerable tax position. Knowledgeable, innovative, forward-thinking tax advice can help you save as much money as possible in these trying times while also helping you avoid unseen pitfalls and false panaceas.

Tax tips for privately held businesses from “The credit crunch: a practical guide”

Get smarter on tax

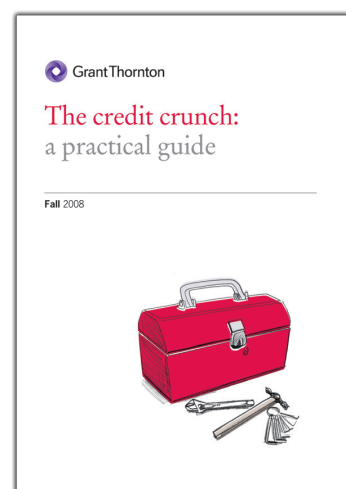
Tax, in its various forms, is usually one of the biggest costs for a business. With the current upheaval in the credit markets, you need to look carefully at how you can reduce tax costs and improve cash flows. The following are some of the simpler ways your Canadian-controlled private corporation (CCPC) can successfully navigate through these trying times:

- Don't make tax payments any earlier than you need to;
- Determine if you qualify for quarterly tax instalments instead of monthly payments;
- Review the balance due date for any remaining taxes for the year;
- Investigate ways to reduce your payroll costs;

- Review your GST/HST and provincial sales tax practices to maximize recoveries; and
- Don't fall behind with your tax payments and other compliance obligations.

Larger corporations will find their ability to claim the small-business deduction is restricted where taxable capital exceeds \$10 million for the preceding year. Determine if there are any strategies available to reduce this amount.

Getting smarter on tax is just one way to ride out the current credit crisis. For more information and advice, download our publication “The credit crunch: a practical guide” at www.grantthornton.ca/insights.



We hope you enjoyed this edition of Catalyst. Your comments on the topics covered here, and your thoughts on what you'd like to read about in upcoming editions are welcome. Contact us at editor@GrantThornton.ca.

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