Financial and Tax Planning in a Private Corporation

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Executive Summary

Purpose of the Report

Creating a new private corporation is a challenging task, of which the most perplexing component is the creation of a new accounting department. Doing so involves an intricately and profoundly devised process of financial and tax planning, in order to ensure growth and profitability.

The Significant Findings

As the foundation of the accounting department, accounts payable and receivable departments must primarily be well organized and working in sync with each other. The accounts payable department is of central importance for a firm that is seeking to improve its cash flow situation. The accounts receivable department has the option of ensuring strong cash flows by remaining conservative in credit-approval and how much credit to offer customers. When deciding about how to report comprehensive income, the management of the new private corporation can choose between having a continuous statement of income or a statement of income which starts with net income. Payroll is another important factor to consider, and deciding what features of a new payroll system in a company to set up is essential; however, the new private corporation may choose to outsource its payroll, as this will enable the senior management and accounting department staff members to focus on daily cash-flow operations. Optimization of accounting software is the first step in creating a foundation which enables financial and tax planning in a new, private corporation to be successful. Upon considering all of these factors, the senior management of a new, private corporation must devise the best strategy to employ in tax planning, in order to reduce corporate taxes and achieve stronger cash flows for the company.

The Conclusions the Author Has Reached

The organization of accounts payable and receivable departments, the reporting of comprehensive income, the optimization of the chosen accounting software, establishing the most important features of the payroll system, and how the new private corporation can best reduce its corporate taxation are the fundamental areas of research which need be explored when planning the financial and tax aspects of a new private corporation. In addition to the academic research conducted on the topic, interviewing of entrepreneurs who are building their own private corporations from the ground up will provide highly conducive information on formulating the best strategy for building a new, private corporation through sound financial and tax planning.

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Research Questions:

1.) Which financial statements are most important to a newly developed accounting department at a private corporation, and how should these financial statements be prepared in a private corporation?

2.) What are important features of a payroll system for a new, private corporation in Canada?

3.) What are the benefits for a new private corporation of outsourcing payroll?

4.) What can accounts payable sub-departments within a private corporation's accounting department do to manage cash flow in an efficient manner?

5.) What should the accounts receivable department do to ensure strong cash flows?

6.) How should comprehensive income be reported in financial statements?

7.) How should financial statements take into account other comprehensive income?

8.) What methods will a private corporation use in is corporate tax planning in order to minimize taxes as much as is possible?

9.) How should a new accounting department in a private corporation, which uses QuickBooks, maximize the functionality of the software in order to operate in a lean way?

Introduction

The financial and tax planning of a new private corporation encompasses the consideration of the following factors:

1.) The roles of accounts payable ensuring resilient cash-flows
2.) Protecting accounts receivable assets against insolvency
3.) Choosing the most appropriate method of reporting comprehensive income
4.) Establishing the payroll system
5.) Choosing the best accounting software for the new private corporation
6.) Developing and implementing the tax strategy which will result in the least amount of corporate tax paid by the new private corporation

The research will focus on deciphering how the most successful corporate financial and tax strategy can be devised for a new, private Canadian corporation.

The Roles of Accounts Payable Departments in Ensuring Resilient Cash-Flows

The accounts payable department is intimately involved in ensuring a corporation has strong cash-flows. Schaeffer (2010, pp. 35 – 36) emphasizes that the accounts payable department can engage in several activities in order to strengthen the cash-flow of the company, of which the following three are most applicable to new private corporations in Canada:

1.) Taking every early payment of discount offered by suppliers
2.) Doing everything possible to minimize the number of priority (Rush/ASAP) checks
3.) Not forgetting to periodically request statements from vendors, insisting that the statements show all activity, including open credits.

A new private corporation usually has as its primary objective the goal of breaking even in the first four financial quarters in which it is operating. Vendors will often offer the incentive of discount if payments are made before the due date. Doing so will save the much needed financial resources of a new private corporation, and will have the effect of increased trust and credibility of the new private corporation, leading to its ability to have improved credit availability with its vendors.

Rushed cheques are those that are issued on a priority basis, in which their creation and routing for payment to the vendor is of utmost priority. There is really only one reason for a rushed cheque to be required, which is that the accounts payable department had neglected to route a payment on time, leading to the threat of suspension of vendor services if payment is not promptly provided. In order to avoid this, the accounts payable department must have a well-organized procedure of payment processing activities, as well as a division of responsibilities among the accounts payable staff. Invoices should be scanned and sorted in appropriate folders which are sorted by vendor names, in the company's computer desktops and in Microsoft Outlook. After the corresponding invoices are routed for payment, the scanned invoices should be moved from a to-do folder to a completed one. Additionally, a strong system of filing the paper copies of the invoices should be kept up to a period of 120 days. The invoices should be stamped with the date and initialed by the processor, lest there be any dispute about its processing and payment.

Periodically requesting statements from vendors, on a monthly basis, and cross-referencing them with the completed invoices folders in the computer data bases of the accounts payable department of the new private corporation would ensure that all payments are up to date; this will ensure that there are no risks of delinquency, and incurred interest charges resulting from late payments.

Protecting Accounts Receivable Assets Against Insolvency

Accounts receivable is a highly valuable asset of a new private corporation. A new private corporation receives a vast majority of its cash flow through deferred payments, which customers pay on a basis that ranges between net 30 and net 90. The expectation of receipt of these payments is the driving force behind the functioning of the payroll system, as well as the payment of vendor invoices, and the purchase of new equipment, as well as intangible assets. Accounts receivable assets need to thus be well-insured through credit insurance. “At the most fundamental level, credit insurance protects a seller against the risk of nonpayment that arises from the seller’s extension of credit terms to its customers.”(Nathan et al., 2014, p. 22) The evident benefit of having credit insurance is to protect the new private corporation against non-payment, resulting in lost accounts receivable assets. In order to safeguard the accounts receivable assets in the most efficient manner possible, the new private corporation needs to be proactive in creating an insurance plan which protects the accounts receivable assets in the manner which adheres to the vision of the new private corporation as a profitable and financial stable organization.

Choosing the Most Appropriate Method of Reporting Comprehensive Income

Comprehensive income is all of the income which is not reported on the income statement. It is important for a new private corporation to generate comprehensive income reports for the purpose of financial budgeting. International Financial Reporting Standards are not inherently necessary to be followed by a new, private corporation in Canada. However, if that company has ambitions of expanding beyond Canadian borders into international markets in the future, adopting IFRS standards from the outset of operations is advantageous in so far that doing so will save valuable time for the company, as well as reduce the enormous strain of switching from GAAP standards to IFRS. Perhaps the greatest advantage to adopting IFRS standards early on is in the ability to attract foreign investment into the company. Keeping in line with this philosophy, the IAS1 of the IFRS enables two choices of reporting comprehensive income: “in a single statement of comprehensive income (similar to general income statement in that it calculates a subtotal for net income and then has a section for other comprehensive income, or as two statements: a statement of profit or loss (separate income statement displaying components of profit or loss) and a statement of other comprehensive income (that begins with profit or loss, the bottom line of the income statement) and displays components of other comprehensive income).”(Orban et al., 2014, p. 651)

Jordan et al., (2014, p. 34) likewise also indicate that there are two ways of drafting comprehensive income statements: “a continuous statement of income with the top part being a traditional income statement leading to the determination of net income, and the items of other comprehensive income (OCI) serving as adjustments to net income in order to derive a bottom-line number or a freestanding statement of comprehensive income that begins with net income, adjusted for the OCI item sin order to arrive at comprehensive income.” (Jordan et al., 2014, p. 34) Further examination into the two methods seeks to decipher what the fundamental differences between the two methods are. “The placement of EPS information represents the main difference between these two variations.”(Jordan et al., 2014, p. 37) The article further reveals the difference the two methods have on reporting comprehensive income in new, private corporation: “more profitable entities exhibited a lower tendency to report comprehensive income in a continuous income statement.” (Jordan et al., 2014, p. 39)

Since a new private corporation is inherently not highly profitable, for the reason that it is engaged in securing its first wave of contracts and cash flow, it should thus adopt the second approach of the “freestanding statement of comprehensive income that begins with net income, adjusted for the OCI items in order to arrive at comprehensive income.” (Jordan et al., 2014, p. 34)

Establishing the Payroll System

Establishment of a payroll system is the principal financial management activity conducted by the founders of a new corporation in the earliest stages of the company’s creation. The reason is obvious, since without a payroll system, employees cannot be paid and as such the company cannot generate operational cash flows. There are several factors to consider, including relationships with vendors. “To manage vendors effectively, payroll managers should implement a vendor management plan. This type of plan consists of identifying and categorizing each vendor and establishing their services and costs.” (Institute of Management & Administration, 2008, p. 15) By ensuring that the vendors’ services and costs are properly matched, the new private corporation ensures that its ability to pay its employees is ensured.

However, the daunting task of often perplexing payroll management can leave many founders of new private corporations intimidated and not up to the tasks. Enter the concept of payroll outsourcing, in which the entire responsibility of carrying out payroll services is allocated to an outside organization, who functions as a vendor of the newly created private corporation. “Most organizations outsource payroll for various reasons such as reducing and controlling costs, focusing on core competencies, accessing domain experts, skills and technologies and getting regular updates on latest payroll/tax laws."(Thomas et al., 2011, p.47) In the contemporary economy of recession, maintaining utmost efficiency and reducing costs is of primary importance for a new private corporation seeking to establish its foothold the particular industry. Thomas et al. (2011, p. 48) state that the benefits to outsourcing payroll are found in: "reducing costs, avoiding problems due to attrition, increasing efficiency, increasing productivity, and compliance with government regulations."

Payroll outsourcing is typically associated with large corporations, who prefer to free up accounting and human resource professionals within their companies to focus on other tasks which cannot be outsourced. "Payroll outsourcing is one of the innovative practices in HR which helps to avoid unnecessary risk and effort to meet various objectives of the organization."(Thomas et al., 2011, p. 53) The findings suggest that new private corporations should strongly consider outsourcing payroll, in order to maximize their resources in the most efficient and effective way possible.

Choosing the Best Accounting Software for the New Private Corporation

Bosona Construction Ltd. is a new, private corporation co-founded by this author. Given this author's previous experience with QuickBooks, the choice was made to use the software ahead of some of the other software previously used by the author, including Oracle and SAP. The primary consideration was the relative cost difference between the mentioned software and QuickBooks Premier and Payroll. The following is an illustration of the costs to implement Oracle and SAP:

Oracle Edition One: $7295.60 (Oracle Corporation, 2014, p. 2)

SAP: Starter Packs - $1178/each (SAP Ask Engine, 2015)

In contrast, this author was able to purchase QuickBooks Premier and Payroll cost for just $775.00.

QuickBooks allows the user the options of: generating and printing a collection of reports, creating multiple report groups, memorizing reports multiple times, collating the group, reporting groups electronically, password protecting electronic reports, report center's custom-defined reports, consistent reporting, ensuring that reports are properly utilized, suppressing account numbers on financial statements, and using Excel to modify the chart of accounts." (Collins, 2014, pp. 65 - 68) As such, the software is versatile, easy to use, and perfectly compatible for use in a new private corporation which must keep its operational costs low, especially those associated with training in more complex software, such as Oracle or SAP.

There are several crucial and important matters to consider when installing the product. They are important to consider prior to the installation of the software in order to best configure the software to the needs of the new private corporation. Yakal (2009) outlines the relevant, important considerations to ponder prior to installing the new accounting software:

- "Check on the tax regulations"
- "Be sure you have complete information about your employees' pay rates and withholding, company deductions, and so on before you start.
- "Pull together your customer and vendor lists."
- "Do you sell products or services? Whether you have them priced out in an Excel spreadsheets or a Word document or on Post-its, have all the info available."
- "Decide how you will set up user permissions."

- "Get your job schedules together."
- "Make a commitment."
- "Get a feel for the program"
- "Enter an invoice or purchase order"
- "Select from a list of business types, so they can create an applicable Chart of Accounts"

The most important part of optimizing the accounting software being used in a new private corporation is to assess the kind of functions which the corporation is in need of from an accounting software. For the purposes of new private corporations of less than fifty employees, such as Bosona Construction Ltd., QuickBooks is the ideal choice.

Developing and Implementing the Tax Strategy Which Will Result in the Least Amount of Corporate Tax Paid by the New Private Corporation

The advent of Great Recession in 2008 and the continuing economic uncertainty in Alberta as a result of the plummeting oil prices of early 2015 have greatly escalated the importance of developing and implementing tax strategies which will benefit new private corporations.

Research has demonstrated that it is more advantageous for a Canadian company to outsource its operations to a subsidiary branch overseas, in order to take advantage of tax breaks provided for by federal legislation. "The government also extended what's known as "exempt surplus" provision to countries that sign TIEAs. This means that a Canadian company with a subsidiary in Bermuda, for example, can bring back foreign profit tax-free in the form of a dividend – provided the subsidiary is carrying out active business, such as sales or manufacturing, and is not merely a P.O. Box." (Castaldo et al., 2014, p. 65) According to the aforementioned resource, TIEA refer to “tax information exchange agreements with off-shore jurisdictions. It’s part of an international effort led by the Organization for Economic Co-operation and Development to curb tax evasion and secrecy. (Castaldo et al., 2014, p. 65) The reality is that this practice allows a Canadian corporation to outsource its operations to a tax-free zone and avoid paying taxes altogether.

For a new private corporation which is based in Canada only, this may seem irrelevant. If the managing partners of the corporations are shrewd enough however, they may choose to outsource a great portion of their operations to a tax free haven and thus avoid paying taxes altogether, depending of course, on the rate of growth and expansion of the firm. As such, a new private corporation can choose to outsource some of its operations to Bermuda, as evidenced by Brookfield Asset Management’s outsourcing strategy. “Brookfield manages an extensive portfolio of office buildings, malls, power plants, toll roads, railways, and other commercial properties across 20 countries, worth about $175 billion. Yet it paid just $1.3 billion in cash taxes worldwide over the past decade, or 12.9% of its pre-tax income.”(Castaldo et al., 2014, p. 66) Palpably, a new private corporation in Canada may find it advantageous to plan for multi-national expansion as soon as it is able to, in order to take advantage of the tax breaks which can result in great tax reductions and retained revenue for the cash flow of the corporation.

Numerous corporations have developed tax departments as completely separate from accounting departments. “Beginning sometime in the mid-1990s, publically-traded corporations began to transform their tax departments from cost centers to profit centers. The tax department shifted its focus from cost efficiency and cost minimization to enhancing shareholder value.” (Donohoe et al., 2014, 856) The recognition of corporate taxation as an area of potential profit signals the shift in corporate mentality that has taken place over the last two decades. With increasing competition of a globalized economy, the shifting of economic power to previously under-developed nations, and the aftershocks of the Great Recession have collectively ensured that profits need be created from areas which lay beyond the scope of traditional product and service combination. When applied to a new private Canadian corporation, this approach is downgraded to a microscopic version of the transformation of the tax department to a generator or profit. While a small private corporation may choose to file its own corporate taxes, in the instance that a managing partner has an educational background in accounting, it is far more advantageous to outsource this to a highly qualified and experienced corporate tax practice. A new, private corporation should thus research and find the most experienced tax specialist firm in its area; special attention need be given to finding the tax specialist firm that is renowned for its ability to reduce corporate taxes. When it comes to tax preparation, it can be said that the mark of an excellent tax specialist is akin to quality in a fine wine; whilst, the latter attains greater quality with age, the former correspondingly increases its level of proficiency with experience. Conclusively, the new private Canadian corporation should develop and implement a tax strategy by hiring the most experienced tax specialists as consultants, and task them with the clear mission of reducing corporate taxes as much as possible. In the long term financial and tax planning strategy, the corporation should strongly consider outsourcing some of its operations to tax havens such as Bermuda, to take advantage of the tax breaks which will retain invaluable financial resources in the coffers of the corporation; the corporation will then use the retained revenue to purchase tangible and intangible assets, hire and train new team members, and allocate funds towards product and service innovation and development, thus ensuring the corporation's competitiveness and future stability in the contemporary economy.

Conclusion

The creation of a new, private company is a courageous task, fit only for those brave enough to combine education and practical experience in order to innovate better methods of conducting business. Essential to the success of a new, private corporation is the creation of its accounting department and the subsequent mapping out of the financial and tax strategy for the new corporation. It is of elemental importance to maintain vigilance in maintaining up-to-date cash outflows in accounts payable departments and cash inflows in accounts receivable departments. A new private corporation should resort to generating the statement of comprehensive income which begins with net income, and ends with comprehensive income, after taking into account those sources of income not immediately present. Payroll should be outsourced to a professional agency outside of the new private corporation, as the benefits of doing so will far outweigh the costs. The accounting software should be simple to use and relatively inexpensive; an excellent choice of accounting software for a new, private corporation is QuickBooks. The tax strategy should be two-fold, with the most immediate plan remaining to use professional knowledge and experienced of highly seasoned tax specialists as consultants, while the long term blueprint for tax reduction should be to expand into multi-national domains and outsource all possible operations to tax havens, in order to reduce corporate taxation. By being aggressively proactive in these endeavors, the founders and managing partners of new private corporations can assure the guaranteed immediate stability and growth of their corporation, with lucrative financial power and dominance of their respective industry being the fundamental long term goal.

Appendices

M. Swinarski, Interview, February 7, 2015

1.) What accounting software do you use at Sagiper North America Inc. and what are the main issues you have found with it?

- We use Sage 50 accounting. We have had no real issues to date, as we have only been using it for 2 months. The software is easy to use and tracks everything efficiently and effectively.

2.) What financial statements do you find most beneficial in the financial planning involved with the building of your company?

- For financial statements and growing our company, we are always looking at our balance sheets, income statements, statements of cash flow, and our bank account transactions of what's going in and what's coming out.

3.) Do you find any advantages in outsourcing your payroll, or do you keep it in-house? Why or why not?

- We keep payroll in house, as we are presently only a two man operation.

4.) What kind of terms of payment do you have established with your customers?

- Payment terms are net 30 will all customers.

5.) What do you do if your customers fail to pay you past your terms of payment and continue to refuse to do so?

- If payments are overdue, we immediately contact our customers' accounts payable department to get an ETA on when we will be receiving it, and follow this up with a Statement of Account being e-mailed to the customer.

6.) Do you use a specialist tax consultant to help you with your corporate tax planning and if so, how do you ensure that your company pays the least amount of corporate tax possible?

- We employ an accountant with over a decade of experience as a tax specialist. He writes off as much as he can to ensure we pay the most minimal amount of tax.

7.) What strategies do you use for minimizing costs with your accounts payable operations?

- As we are only a two man operation starting up, keeping costs to a minimal is quite difficult. We track our spending on a weekly basis and only make purchases that are mandatory.

D. Misiaszek, Interview, February 9, 2015

1.) What accounting software do you use at Fancy Cleaning Ltd. and what are the main issues you have found with it?

- I use QuickBooks. It's cheap and easy to use. My educational background is in education, so QuickBooks is perfect for me because I don't have any training in accounting.

2.) What kind of terms of payment do you have established with your customers?

- Since everything my company does is on the basis of contracts, I usually receive a cheque in the mail, within 3-5 business days of the completion of the contract. But if the contract is a continuous one, in other words a weekly-basis, I just get the customer to pay me once a month, through cheque.

3.) How do you administer payroll?

- I write my employees a cheque. I don’t want to hassle around with direct deposit.

4.) What do you do if customers fail to pay on time?

- My belief is that late payments are due to poor customer service. I make an effort to see all of my customers in person at least once every two months. It not only gives them a chance to see me and for me to develop that business relationship with them, but it also enables me to put them on the spot to pay me, because it is hard for someone to deny paying you when you’re standing in front of them.

5.) Who handles your taxes for you?

- A good friend of mine is a tax specialist. He does a really great job, and in return, my company provides cleaning services for his office for free.

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