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Claiming Business Expenses

*T2125 Overview for
Self-Employed Individuals*



Business Income and Expense Definition

Business Income:

You may have self-employment income from a business, a profession, commission, farming, or fishing. Business income includes income from any activity you carry out for profit or with reasonable expectation of profit. A business includes: Products sold (sales); Services rendered (commissions, fees, etc.); Subsidies; Grant; Tips (not on your T4 are included in other income, line 104, employment income.)

Rents may be income from property or from business depending on the services provided to your tenants. In most cases, you earn income from property if you rent space and provide basic services only, such as heat, light, parking and laundry facilities. If additional services are provided to your tenants, such as cleaning, security and meals, you may be carrying on a business.

When providing a customer with an invoice, it must include: Business name, the date, an invoice number, a description of the good or service, a separate line for HST, your HST # (if applicable), the total amount, the payment method used, and the terms of the payment.

Business Expenses:

In general, you can deduct any reasonable current expense you paid or will have to pay to earn business income. Expenses must be supported by proper documentation. As a general rule, if an expense was incurred to earn the business income, you may be able to claim this as a business expense. The CRA has a list of common business expenses that you can deduct: See: <https://bit.ly/2fpP4tJ>

Deduct only the business part of the expenses from business income. You cannot deduct personal expenses. In addition, you cannot claim expenses you incur to buy capital property.

You may acquire capital property such as a building, furniture or equipment to use in your self-employment business activities. You cannot deduct the cost of these properties when you acquire them but because these properties may wear out over time, you can deduct their cost over a period of several years. The deduction is called capital cost allowance. The amount you can deduct each year will depend on the type of capital asset you acquired, the class of the asset and the capital cost allowance rate of the class of the asset.



The timing of a deduction will depend on what reporting method you use. Farmers, fishers and self-employed commission agents can report their income using either the cash method or accrual method. However, all other self-employment income must be reported using the accrual method.

If you are eligible to use the cash method to report income, i.e. you are reporting farming, fishing or self-employed commission income, expenses can be deducted when they are paid and revenues are included in income when received.

The accrual method requires you to report income in the fiscal period you earned it, no matter when you receive it. You deduct expenses in the fiscal period you incur them, whether you pay the expense in the same period or not.

When are taxes due?

Individuals have to file their tax return by April 30th. Self employed individuals have until June 15th to file, however, if any taxes are due, the CRA begins assessing interest as of April 30th. Self employed individuals will complete and submit a T2125 - Statement of Business and Professional Activities. See: <https://bit.ly/2wa0nOT>

Corporations fiscal year end is established when the corporation is set up. Taxes must be filed no later than 6 months after the end of each fiscal year.

Main Operating Expenses that can be deducted from taxes

Business Start-up Costs

You can start deducting your expenses when your business starts. Generally, your business is considered to have started when you begin to have significant activity that is a regular part of your business or that is necessary to get the business going. For example, if you decide to purchase enough goods for resale or equipment to start your business, you may be considered to have started your business. However, you may not be considered to have started a business if you are doing research on how to start a business. You would not be able to discuss the expenses you incurred for your research.

Supplies

You can deduct the cost of items that your business uses indirectly to provide goods or services. For example, small tools that cost less than \$500 bought by a renovation business, or cleaning supplies used by a hair salon.



Business taxes, fees, licenses and membership dues

Taxes, fees, licenses and membership dues are deductible, however you cannot deduct club membership dues including initiation fees if the main purpose of the club is dining, recreation, or sporting activities.

Office expenses

You can deduct the cost of small items such as pencils, pens, stamps, paperclips and stationery. Do not include office furniture as they are capital items.

Business use-of-home expense

You can deduct expenses for the business use of a work space in your home, as long as you meet one of the following conditions:

- It is your primary place of business; or
- You use the space only to earn your business income, and you use it on a regular and ongoing basis to meet your clients, customers, or patients.

You can deduct part of your maintenance costs such as heat, home insurance, electricity and cleaning materials. You can also deduct part of your property taxes. To calculate the part you can deduct, use a reasonable basis such as the area of the work space divided by the total area of your home.

If you use part of your home for both your business and personal living, calculate how many hours in the day you use the rooms for business, and then divide that amount by 24 hours. Multiply the result by the business part of your total home expenses. This will give you the household costs you can deduct. If you run the business for only part of the week or year, reduce your claim accordingly.

To help calculate your business-use-of-home expenses, complete the "Calculation of business-use-of-home expenses" on Form T2125, Part 8. (Link to T2125 on Page 1 in "When are taxes due?" section.)

Check the CRA Business-use-of-home expenses webpage for more information:

<https://bit.ly/2yF92ZO>

Salaries, wages, benefits

You can deduct gross salaries and other benefits, such as Canada Pension Plan and Employment Insurance premiums you pay to employees.

Meals and entertainment expenses

The general rule for deductions related to meals and entertainment expenses is that you can deduct up to 50% of the meals and entertainment, or "an amount that is reasonable in the circumstances", whichever is less.

Travel

In most cases, the 50% limit applies to the cost of meals, beverages, and entertainment when you travel.

Rent

You can deduct rent paid for property used in your business. For example, you can deduct rent for the land and building where your business is situated as long as this is a commercial location.

Management and administration fees

You can deduct management and administration fees, including bank charges incurred to operate your business. Bank charges include those for processing payments.

Motor Vehicle Records

You can deduct motor vehicle expenses you incur to earn business income but only when they are reasonable and you have receipts to support them. A reasonable vehicle expense would be based on the kilometers driven to earn business income relative to the total kilometers driven in a fiscal period. The best evidence to support the use of a vehicle is an accurate logbook of business travel maintained for the entire year, showing each business trip, the destination, the reason for the trip and the distance covered.

The types of vehicle expenses you may be able to claim include:

- Maintenance and repairs;
- Leasing costs;
- License and registration fees;
- Fuel and oil;
- Insurance;
- Interest on money borrowed to purchase the vehicle.

Interest and bank charges

You can deduct interest incurred on money borrowed for business purposes or to acquire property for business purposes. Check the CRA website for limits:

<https://bit.ly/30iMw6H>

Property taxes

You can deduct property taxes for the land and building where your business is located. Note that the property tax related to business use of work space in your home has to be claimed as a business-use-of-home expense.

Telephone and utilities

You can deduct expenses for telephone and utilities such as gas, oil, electricity, water and cable, if you incurred the expenses to earn income.

Insurance

You can deduct all ordinary commercial insurance premiums you incur on any buildings, machinery, and equipment you use in your business. Insurance costs related to your motor vehicle must be claimed as motor vehicle expenses and adjusted for any personal use.

Bad debt

You can deduct an account receivable if you had already included the account receivable in income and you had determine that an account receivable is uncollectable in the year.

Advertising

You can deduct expenses for advertising, including advertising on Canadian radio and television stations and in Canadian newspapers. Digital advertising is also tax deductible.

Need more help understanding your tax obligations?

Our partners at Grant Thornton LLP can help you.

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Also available:

The Canada Revenue Agency offers a free Liaison Officer service to owners of small businesses and self-employed individuals with in-person visits and pre-arranged seminars.

A liaison officer can answer your tax-related questions, discuss common tax errors and explain best practices.

Link to the Liaison Officer Service: <https://bit.ly/2AhuoOE>