GUIDE TO CANADIAN TAXES FOR FREELANCERS

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INTRODUCTION

If you find yourself as an entrepreneur, freelancer, or contractor, how do you end up doing all the tax and accounting stuff?

There is a plethora of information on the CRA's website, but it's quite difficult to find the actual answers you're looking for, because all that information is broken up across hundreds of forms, help files, guides, and interpretation bulletins. Even when you find what you need, understanding it can be difficult or vague and confusing ("you *may* have to…"). Combined with the fact that people tend to look up tax information at the last minute in tax season and that taxes are confusing and stressful at the best of times, oh and that the onus is on the taxpayer to figure it all out and it can seem hopeless.

So here is a mini-guide to being a sole proprietor (aka freelancer aka having a side business).

Disclaimer: *I'm not an accountant, and even if I was, I'm not sitting with you looking at your personal tax and business situation. Unfortunately,* ***the onus is still on you*** *to make sure that you're filing correctly. I hope that this guide will be a useful first start, but that's as much as it can be.*

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Part 1: Entrepreneurship in Canada, Where to Start

Canada is a very friendly country if you want to start your own business. Here is what you need to do to become a freelancer/entrepreneur/self-employed/sole proprietorship:

1. Start doing business.

That's it. The rest of this guide will talk about how to handle the money when it's coming in and pay taxes on that, etc., but there is absolutely nothing standing in your way if you see an opportunity to perform a service or sell a good — you can start your business on the fly and figure the rest out later.

Now that's a bit simplistic, sure. You don't need to register for a corporation number, get approval from a business registry, or possess a special license to make some side income or start a small business *in general*. But eventually some of those things may come into play. And depending on what you do there *will* be some restrictions or requirements for specific industries. For example, there's nothing in my way of becoming a freelance editor, but if I wanted to become a self-employed cab driver I would need to get a taxi plate and have my car inspected. There's nothing stopping me from selling hand-knit socks or reselling guitars, but there are health and safety regulations if I wanted to sell cookies and other food products, and licenses I would need to sell mutual funds or insurance.

If you just do business as yourself, that is under your own personal legal name, there's no registration to be done. If you want to use the snazzy business name that you came up with, you'll have to register that name with your province. So for example if I'm performing editing services and bill clients as "John Potato" (assuming for the moment that's my real name) then all is well. If I want to put my snazzy "Stormageddon Editorial Services" at the top of my invoices, then I'll need to register that name with the province, which in Ontario costs $60 for 5 years.

So if you've got an idea and an opportunity for a business venture or some freelance income, go ahead and get on it — you can sort the other stuff out in short order.

PART 2: RECORD-KEEPING AND GETTING PAID

Some people have snazzy programs to help them keep their business books. Others use basic spreadsheets, and even pen & paper ledgers. In a nutshell, you want to record how much money you have coming in, and the expenses you incurred to make that money. The difference (your net income) is what you'll pay taxes on. Keeping good books in line with what the CRA expects from the get-go is ideal, but as long as you have records of everything in a way that makes sense *to you*, you can translate it into your tax form in the spring.

For every expense you will need to keep a receipt to justify it. If it's not immediately apparent how a receipt links to a legitimate need for your business, make a note (and keep that note somewhere you'll find it later, like in your spreadsheet or paper-clipped to the receipt, or both). In particular, if you take a client or collaborator out to lunch or coffee to discuss business, write down who was there and what you talked about on the back of the receipt to show you're not just trying to pass off your own personal lunches as business expenses. If you get a parking receipt, likewise link it to a meeting.

Keep other documents to justify things like exchange rate charged (e.g. credit card statements). However, note that credit card statements are not sufficient for backing up expenses on their own — you'll need original, itemized receipts from the store or service provider.

You'll need some kind of record of your income too, and your customers may very well want receipts of their own. Here is an invoice template I've put together that you can start from. In that template are a few tips on the important points for your invoice to cover, including your name, a date, a detailed description of what you sold and any HST/GST applicable, and your customer's name.

You can do all your tracking with very simple spreadsheets, but there are programs out there that will help you with your record-keeping, which can even integrate with your invoicing and bill payments. I myself use spreadsheets, but I reached out to a few sole proprietors to get their take on some other products.

Sandi Martin and Jen Polk both put their vote to FreshBooks. I've never used it but in brief it helps track your expenses (including taking pictures of your receipts), and integrates with Stripe and PayPal so you can get paid automatically from your invoice. It's a monthly cost (starting at $9.99, with higher fees for the ability to bill more clients) and reportedly quite easy to use (oddly enough though, even though FreshBooks is Canadian, those fees are USD). I may have to come out of the spreadsheet stone age and check it out myself (***as if I'll give up my spreadsheets***).

Kyle Prevost and Cait Flanders like Wave, which does what it needs to do and is ***free***. Both of these were discussed on a recent episode of Because Money. I had a few *mentions* of QuickBooks when I asked around, which uses double-entry accounting, but no personal endorsements for it.

Getting paid is perhaps the most important part of being in business for yourself (by and large it is the reason for doing whatever it is you're doing). I like to make it as easy as possible for my customers to pay me. Cash, cheque, Interac e-mail transfer, PayPal or credit card — whatever works for them. A few neat services to think about when accepting credit cards are PayPal (which lets you send invoices and set up an electronic storefront), Square (which lets you swipe credit cards in person using a little attachment for your phone and also send out invoices to be paid by credit card), and Stripe (for APIs to play with lots of e-commerce stuff, including Thinkific). Intuit has a similar mobile payment card-reader-thing to Square, but only plays with iOS devices. As convenient as it is for your customers to pay by credit card (with any of these services), there will be credit card processing fees that come off the top, so understandably many small businesses are reluctant to accept them and insist on cash, cheque, or direct money transfer (such as Interac e-mail transfer). Which way works best for your business is totally up to you.

PART 3: TAXES, T2125, NET INCOME

Net income is a basic concept: not every dollar you bring in the door is your profit, some has to go towards the expenses of running your business — you're only taxed on your net income. Even once you have a good idea of how much you really made after expenses, figuring out how to file your taxes can be confusing.

There's a handy little line in your tax return called "other income, line 104" which bills itself as the place to put "employment income not on a T4 slip", which includes "occasional earnings from short-term, impermanent employment." Well, many of you freelancers and occasional drive-way shovelers are probably thinking that this sounds like you. Sorry, but even if you think of yourself as employed by your clients, you're likely in business for yourself and should instead be filling out the lovely **T2125** form for reporting business activities. (Yes, it's weird to think of moonlighting for a few hours as a freelance writer or whatever as "running a business" but that's how the CRA sees you — and this is another example of how the descriptions on the CRA website can be confusing).

Once you know that the T2125 is the place to focus your attention, the trick is to translate all of your common-sense (or ad hoc) record-keeping over to the categories the CRA has set out for you. If you can organize your records to align with the T2125 in the first place you may be ahead of the game.

There are three main sections for listing your expenses here: the first part for common, direct business expenses, the second part for your business-use-of-home-expenses, and the last part for the depreciation (capital cost allowance) of things that will last a long time, like your computer and desk.

You will have to recognize that there is a personal use element to many expenses as well as a business use, and your personal use of something is not a valid expense to reduce your taxable income — but by the same token, just because you may pay for something out-of-pocket personally doesn't mean it's not a legitimate business expense (at least partially) for your sole proprietorship. For example, an internet connection is pretty much essential for many freelancers. But most people would have an internet connection for personal use *anyway*. So you can't claim 100% of your internet bill as a business expense, but it is fair to claim a portion of it for business purposes. This is explicit in the rules for meals & entertainment, where you can only include 50% of the cost as an expense.

For those who work at home, there's a whole section for the business-use-of-home expenses, where you can claim a portion of your rent (or mortgage interest and property taxes) and utilities as a business expense. You'll have to pro-rate this for the amount of space that is dedicated to your business (e.g. a home office) vs. the total space, to recognize that there is a substantial personal use component to your home.

Notes on the T2125:

In the first section there's a line for "Rent" but this is not for your apartment rent, there's a separate business-use-of-home expenses for that. The rent line is for dedicated commercial rent (i.e. if you rent a storefront or unit in an office building).

Conferences: listen up, CPFC attendees, we are allowed to write-off a portion of up to two conferences per year that relate to our business (which CPFC does for me). However, we have to back out any meals. If meals aren't itemized separately, we back them out at a rate of $50/day (which is weird that it doesn't distinguish between a cold buffet lunch and a multi-course dinner in that rate — or even that sometimes a conference may have several meals while others just have one), which then can go into the meals & entertainment category (so $25/day of food ends up being personal use and not expansible).

Cost of goods sold and inventory: when I keep my simple spreadsheets for my own personal use to see how my business is doing, I do it on a *cash basis*: as soon as I spend money to order more books for my inventory, I see that money as gone for my personal use (because I can't eat the books). However, the CRA wants me to act like a proper business and pretend that there's still going to be a market for books next year, so any that are left at the end of the year are carried forward as inventory and not expensed (though that will balance out next year).

Only the portion of things used to run my business in 2015 count as expenses — if I paid for more (e.g., for a year's worth of web hosting services, or a box of books that will partly be sold in 2015 and partly in 2016), then part of that expense counts against 2015's income, and part gets carried forward to 2016. Similarly, your income is recognized when earned, so even if a client hasn't paid me yet and it's 2016, if I did the work and sent the invoice in Dec 2015, that income will count towards my 2015 tax year.

Assets and depreciation: Not all expenses are fully expensed in one year. If you buy a new computer for your business, that's going to have value and contribute to your earnings over several years, and the CRA has set up a system to recognize that. You'll enter a value for the item and depreciate it over a number of years, or in CRA parlance, the capital cost allowance (CCA). Fortunately, most tax programs will take care of this and carry-forward the residual values for you.

Industry classification: this little number helps the government classify your data for use in various industry statistics. It can be really confusing and if multiple things appear to match, my understanding is it's ok if you're not precise. Aside from using it for statistics, this classification helps the CRA predict the kind of expenses someone in your industry is likely to have. If you say you're in retail but have no cost of goods sold (like would be expected for a consultant or someone in a service industry), buckle up for an audit.

Remember, write-offs are not magic. They reduce your taxable income, so a written-off expense is not free, it's cheaper by the amount of your tax rate. So if you pay 30% on your income and get to write off attending a conference, that isn't ***free***. Minimizing expenses is usually the strategy you want to follow.

How much will I end up owing? That depends on how much you make, just like income from your day job. If it's your first year in business, set aside 30-50% of what you bring in so you'll have money ready to pay your taxes at the end of the year. After that you should have a better idea of what you need to allow for.

If you have a day job then you likely already pay — and possibly max out — your CPP contributions. If you don't then you will have to put aside part of your income for that as well, and as a self-employed individual you'll have to pay for both your share and the employer's share. On the plus side, half of the CPP you'll pay (the employer portion) counts as a tax deduction (i.e. subtracted from your income), and the other half will generate a tax credit for you.

We'll revisit the T2125 in part 5, but know that your typical tax software packages will be able to handle this for you. For TurboTax, they have multiple tiers — ***all*** tiers (including the standard version) can handle your sole proprietorship taxes and the T2125, you don't need to shell out an extra $75 for "Home & Business". What that higher price gets you is a tiny bit of extra support for filling it out (i.e. the wizard), but if you can enter your information into the forms directly then you won't need that.

The CRA has a 58-page guide on sole proprietorships and this form, which sounds kind of crazy, but it's basically about trying to interpret how to translate whatever accounting system you have into the T2125's categories (plus a few special rules, like that one about only being able to claim 50% of meals & entertainment expenses). So really the worst part of this is doing it for the ***first*** time — after that you should have an idea of the mapping function to turn your accounting system into a tax return. Try to fit your expenses into existing categories where possible, but there will almost certainly be something that falls under "other" (e.g., webhosting and other technology license subscriptions still hasn't been created as a category on the form even though many businesses require it these days).

PART 4: SALES TAX, HST REGISTRATION

HST can be a post series on its own and I don't want to get too lost in the weeds on it, especially as I am myself a small supplier. But it can be very important so I want to touch on a few points, especially to reinforce the initial message that **the onus is always on you to figure all this tax stuff out**. When you hit the threshold for registering, it's ***on you*** to go ahead and register, no one will tell you (until it's way too late and then that notice comes with penalties).

Briefly, HST (GST) is sales tax that you charge your customers on goods and services; you then have to pass (remit) those taxes collected back to the government. HST can be a bit of a pain, especially because it's a parallel system to income taxes — you file and pay separately, and it's not handled by your tax software (e.g. TurboTax, UFile, SimpleTax, etc.).

Fortunately, most people conducting side businesses (or just starting up) don't have to collect HST because there's the **small supplier** exemption: if your sales are less than $30,000 per year, you don't have to register or collect HST (note that this is the previous four calendar quarters, so if you have lumpy income you may cross the threshold even if your calendar year income works out to less than $30,000 in each year — also note that some industries have to register right away, like taxis). So if you're a small supplier you don't collect HST, you don't file, you don't have to pay it to the government — another barrier to getting started and trying something out that's not in your way. But remember that as your business grows you may hit that point where you'll have to register, and it will be up to you to notice and remember to do that.

Once you register and start collecting HST, you'll find that the amount of HST you charge depends on where your customer is located: if you're in Ontario and your customer is in Alberta, you charge them that (GST) rate; your customers in Ontario get the Ontario HST rate, etc. It's not just one rate for everyone based on where you are. This can lead to a massive headache if you're selling small-ish items at retail and your store software isn't set up to handle the tax (for that reason, if I cease to be a small supplier I'll likely shut down by book storefront, and let a retailer handle it). If your customer is in the US (or other international spots) then you won't charge them HST at all — but note that those sales do count towards determining whether you're a small supplier. If all of your business is to US/international clients, you can be in the strange situation where you cross the $30,000 small supplier threshold and have to register for HST… but then not actually charge HST to anyone because they're all "zero-rated".

So, as long as your business is a side thing or just starting up, you can more-or-less ignore HST, and just watch to see if you no longer count as a small supplier. Once you cross that threshold, you **must** register. That will give you a HST # to put on your invoices/receipts, and make it so that you have to file a separate HST return each year.

The HST return is a bit of an odd duck in that it's not technically due to be filed until the end of June of each year, yet you must pay by the end of April. If you use the quick method, you'll also need the amounts of your "benefit" for your income tax return in April. All that means you can ignore the posted deadline of June and realistically plan to have your stuff together by March/April.

The essence of HST filing is to report how much you made in sales, how much HST you collected on behalf of the government, and then subtract what you paid in HST on your own supplies in the course of running your business. If you're primarily service-based (i.e. don't have a tonne of input HST costs to claim) then you'll likely want to look into filing with the **quick method**.

The quick method lets you estimate your input credits as a percentage of your HST, which is both faster for reporting, and may mean you get to pocket some of the HST if you have very low input costs (note though that this is a taxable benefit — the amount you get to keep from the quick method will get added to your income in your T2125 in your income taxes). The worst part of this whole thing is *The Most Confusing Table in The World* that lists where your business is (participating/not participating/Nova Scotia/PEI) against the same labels for where your "supplies made" — which is a really weird way of saying sales. Now Canada only has 10 provinces and 3 territories, so this table *could* completely explicitly list each one for perfect clarity, but instead chooses this insanely obsfucating language instead. So for reference, Ontario is a "other participating province" so Wayfare (and I, if I ever cross the small supplier threshold) will look to that last column and row, and remit 8.8% of supplies, less $300 (or, again to put it in a confusing way, 1% on the first $30,000 in supplies).

Participating provinces here mean those that have HST as a single sales tax instead of separate GST and provincial sales tax. Now what's extra confusing for this table is that this CRA page tells me that there are only five participating provinces: New Brunswick, Nova Scotia, Newfoundland and Labrador, Ontario, and Prince Edward Island. Two of those are already treated separately in that confusing table; could the other three not get called out?

In another "you have to figure this out on your own" note, you have to pay your HST by quarterly installments if your net tax owing is $3,000 or more in a year — but they won't tell you in advance that you've hit that point and that it's time to start sending more money along more frequently.

Finally, in a comment on part 2 Jen points out that you may want to consider registering for HST even if you're a small supplier in order to make your business seem more legitimate in the eyes of your clients.

PART 5: STORMAGEDDON EDITORIAL EXAMPLE

One night, Potato was at a party when he heard a friend say that she was writing a book and needed recommendations for an editor. “Hey,” he said, “I edit stuff. What do you need?” Seeing the customer need, he became a freelance editor and was open for business in that moment. They agreed on a price, and after the party Potato sent an email to confirm the work and the terms so the expectations were clear on both sides.

> Dear Author:
> As discussed tonight, I will do a developmental/substantive edit of your book *The Rings of Jupiter*. I will [specifications of the work to be done].
>
> This will be for a flat rate of $1100, payable in 3 installments of $100, $500, and $500. I will send you a sample edit of the first few chapters for the first installment, at which point you can cancel the contract if you’re not satisfied with the work. The second installment will be due after I complete a first-pass through the whole book and detailed edits to chapter 10. The final installment will be due upon final delivery. Edits will be in the form of tracked changes and comments within the MS Word. Please expect the work to take approx. 4 weeks.
>
> Acknowledging the editorial contribution in the final published copy would be appreciated but not required.”

Potato then sends a basic invoice for the first installment, using his legal personal name.

Before the final installment, Potato realizes that there’s a demand for this kind of work from all kinds of authors and organizations, and that it could be a viable side business. He dreams up the name Stormageddon Editorial and registers the name with the province of Ontario. The final invoice has the Stormageddon branding on it.

To really get Stormageddon Editorial off the ground, Potato creates a website, and orders a new laptop to be dedicated to the business. He clears off a table in the den to be a dedicated workspace. Over the next few months he gets a few more contracts and records them (along with associated expenses) in a simple ad hoc spreadsheet, and racks up a few more general business expenses, including visiting a conference to learn more about freelance editing and build his network.

Click here to see the spreadsheet created for internal purposes (i.e., on a cash, common-sense basis).

Now to translate this [into the form the CRA expects it (the T2125)]().

Revenue maps to revenue, so far so good. It's a service business with no employees, and a small supplier so no HST, and the first page rolls by pretty quick.

The expenses will have to be categorized, some of which will become capital cost allowances (depreciation) rather than straight expenses. We'll also get to throw in the personal use of home, which for my own internal understanding of how the business was doing I wasn't really considering.

Here are my sample expenses:

1. Postage, Canada Post
2. Envelopes, Staples
3. Laptop, Dell
4. Website hosting, Dreamhost
5. Dinner with Client 1, Classy Pizza Joint
6. Business name registration, Province of Ontario
7. Conference Registration
8. Parking for conference
9. Consult – WordPress

I'll pull up my T2125 and the CRA's guide for this — of course, that's a 58 page monstrosity, which is why I'm writing this blog series in the first place.

Ok, so #1 and #2 look to fit neatly under office expenses.

The computer, #3, is a capital cost item, class 50, and so will go down in that section.

#4, the annual website hosting and domain registration bill, is a bit tricky, because now I have to decide if I want to live in CRA pedant-ville or not. All that stuff in the legalese preamble says that I have to account for expenses as they're accrued, so the year of webhosting I purchased in August will have to be split up into the portion used in 2015 and 2016, and each part claimed in the appropriate tax year. This makes a good case for arranging to have annual costs come up in January/December. Anyway, $144.74/12 = $12.06/mo, times five months used in 2015 = $60.30. There isn't a spot for web hosting, so I'll add it to "Other". The rest of that cost will be carried-over to 2016.

#5 is covered in the guide — entertainment is allowed, but only 50% of the cost, so only $33.50 goes into line 8523.

#6 I'll put under line 8760, business licenses.

#7 will also go under "Other", but because the conference included a day of meals that weren't itemized separately, I need to take off $50 for the personal use for meals — but half of that ($25) I can add back as an expense under meals and entertainment, so that's now $58.50 under meals and entertainment, and another $148.50 for other.

#8 Parking: there's a line for motor vehicle, but it's for everything *but* parking. I'm not going to claim anything for the business use of my personal car — it's a massive headache to keep a mileage log, and I know it's a miniscule amount. However, the parking receipt I can directly tie to a business activity, so I'm claiming that, but apparently under "Other" ($12).

#9 Consultation: This is another head-scratcher. It's not quite a "professional" fee, but maybe? I figure there's too much grey zone there so I'll stick it under "Other" as well ($120).

So you can see that even in a fairly simple example there's some confusion, grey zones, non-obvious things, and complication. There are clear lines for things like rent, telephone and utilities, and property taxes, but these are not the spots for your business-use-of-home expenses — those go down below. These lines are only if you're snazzy enough to have a separate office space (like in a commercial/industrial building). And the "Other" category gets a pretty good workout.

Next I go down to part 8 and fill out the business use of home expenses part. I start by entering the total that I paid for the various categories (in this case for just 7 months as I started fictional Stormageddon Editorial part way through the year, but for subsequent years I'll use the full 12 months that it was operating as a side business out of my home). What's really weird is that the form is not set up with rent as a line here (which adds to the confusion when there is a line for it above). So rent, along with phone and internet, will go under "other".

Now I have to figure out what portion of those expenses would be for my own personal use, and which can legitimately be counted as part of operating my business. I use a basic square footage calculation, detailed in the spreadsheet, and figure that 6% of the house has become dedicated to Stormageddon Editorial. So 94% of those costs are personal, and $949.74 is added to my expenses.

There is a bit of weird up and down action on the form here, as I have to go down to CCA (next paragraph), back up to the basic net income calculation, get the net income to figure out if I'm allowed to claim business-use-of-home expenses (if you make very little, you can't have your business-use-of-home expenses create a loss, you can only carry those expenses forward until your business shows a profit), then back up to the net profit calculation to enter those expenses. Phew, I'm tired after all that up and down scrolling (your tax program will do this for you if you use one).

Finally, I go down to the capital cost allowance section and plug in the details for my computer purchase. Doing this by hand is a bit of a chore: adding the new equipment, figuring out how much of it to claim this year versus carry-forward (which involves reading the guide a lot). Thankfully, most tax programs will take care of this from the additions stage onward. So, I've put down in area B that it's a class 50 item (computer), a description no one but me will read, the total cost, and the business use part (in this case, 100%). Then that gets brought up to area A under column 3. For column 6 I have to make an adjustment for the fact that the equipment was added this year (I can't claim a full year of depreciation yet), so half that cost comes off. Then I take the rate for computers (class 50 = 55%) and that's how much of the amount I take this year. Next year, I'll take 55% of the value left on my laptop as an expense, and so on until it's all written off or I dispose of it.

My bookkeeping got a bit more complicated: not only did I have to translate my very quick and straightforward cash-based internal tracking to the tax form, I now need to track which things I paid for in 2015 will count as expenses in 2016. My tax program will automatically handle the computer (capital equipment), but I'll have to track the web hosting and any other partially allocated costs.

And while it's not quite as simple and straightforward as we might wish, that is it — we've launched a business and reported it on our taxes!

I hope that's been a helpful series, and will help orient you to the CRA guides. As a final disclaimer, remember that I am not an accountant, and I am especially not *your* accountant. The onus is on you to ensure you're doing your taxes correctly.

AFTERWORD

A big note of thanks to Sandi, Cait, Chris, and Jen for their feedback on the post series while it was in draft form, particularly the non-stone-age-spreadsheet software recommendations.

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