

## Simeen Gaidhar-Bhanji, Financial Expert Columnist



Simeen Gaidhar-Bhanji, CA is a Partner of Simeen Bhanji Chartered Accountant that offer a variety of services to corporations and individuals ranging from tax planning and consulting, compilation, reviews and audits of financial statements, corporate and personal tax returns, GST/PST services, and consulting for internal control, financing and tax.

### **Make sure your accountant and lawyer meet before tackling the vexing issue of franchise taxation**

Sure, turning your business into a franchise is a proven way to grow it. But wait, there are taxation issues you should be aware of. If you jump into franchising without recognizing these issues, you could find yourself treading on a financial landmine.

Franchise fees and royalties, for tax purposes, are treated according to the terms of the franchise agreement. How you word this document can make a big difference in terms of tax planning, and the overall taxes you will pay or save on a yearly basis.

The wording will also determine the obligations that you, as franchisor, have to your franchisee.

For example, a client of mine had a three-year franchise agreement by which they were required to provide advertising and support in exchange for the original franchise fee. Let's assume that the franchise fee was \$60,000. This meant that, each year, the client would take into income \$20,000 (i.e., \$60,000 over three years), which would result in taxes. The royalties were taken into income as well, regardless of payment, but based upon earnings.

Because the amounts were spread over three years, we were able to save on the taxes and find more annual write-offs to reduce the overall tax bill. Depending on your business income, this could be vital if you are close to reaching the limit for the small-business deduction. Once you exceed that limit, your taxes could increase from 16 percent to 33 percent.

The franchise agreement that you have with your franchisee is your single most important document. It sets out the amount you will receive from franchisees, as well as the terms under which the franchise system works. A word of advice: get your lawyer and accountant to work together in creating the agreement so that you are protected and have the franchise terms arranged in the most tax-effective way.

We have many clients who decide expand their business by franchising. Having us, as their accountant, sit with their lawyer to draw out the details has proven to be a great benefit to them. Setting out the details also assists with cost efficiencies, as often there will be a lot of back-and-forth between the lawyer and accountant to finalize the process.

What do I need to get started for franchising my business?

Having a business plan in place for your current business is extremely important. This will assist you in preparing the franchise offering down to the finest detail. The plan will also take into account how franchising will impact your business.

Standard in your franchising business plan will be a projected cash-flow statement taking into account all the cash transactions, including your franchise fees and royalties, that you will collect from franchisees. Make sure you do your research. You need to know as much as you can about your industry. Seek out guidance from businesses similar to yours. For example, find out what they charge their franchisees. This help you determine what you will be charging for both the value of your brand and the support that you will give to your franchisees.

The above is for information purposes only, and therefore prior to making any decisions, please contact your accountant for advice.

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