

## Income Taxes - A Necessary Evil

Who doesn't dislike paying their income tax? However, most Canadian taxpayers, including owner-managers, understand that paying their fair share of income tax is simply the price of living in Canada with its many benefits. It is not surprising that those who *do* pay their share of income taxes are justifiably outraged by those who do *not* pay, especially if it appears they are able to get away with it.

Tax avoidance, or minimization, is the skillful use of the tax laws to minimize the amount of tax owed. Tax evasion, on the other hand, may be defined as failing to report taxes owed, reporting inaccurately or using some illegal means such as fraud to reduce the taxes owed under the tax laws.

### The Cost to Taxpayers

The cost of delinquency to the people of Canada is enormous. Tax Justice Network, a London-based independent organization created in 2003 to monitor tax systems around the world for fairness and transparency, claims the people of Canada lose about \$81 billion annually through tax evasion. That's four times what we spend on defence and almost one third of what we spend on healthcare every year.

In fact, tax evasion is taken so seriously by the Canada Revenue Agency that it has a "Newsroom" [www.cra-arc.gc.ca/nwsrm/cnvtcns/menu-eng](http://www.cra-arc.gc.ca/nwsrm/cnvtcns/menu-eng) where it uses court records to publish press releases announcing convictions for tax evasion. The CRA does this "to maintain confidence in the integrity of the self-assessment system, and to increase compliance with the law through the deterrent effect of such publicity".

### The Cost to Delinquents

Punishment for tax evasion can be a fine, jail time or both. Convicted tax evaders must pay the full amount of taxes owing plus interest and any civil penalties assessed by the CRA. Failure to file a tax return can lead to a fine of between \$1,000 and \$25,000 and as much as 12 months in jail. Making a false or misleading statement on the tax return or wilfully evading paying taxes can bring a fine of between 50% and 200% of the amount of tax owed and a two-year prison term.

### Rogues Gallery

The following examples from the 2011 "rogues gallery" is only a small sampling of the kind of violations prosecuted by the CRA.

#### 1. Failure to Comply with a Court Order

In June 2011, the Ontario Court of Justice found a taxpayer guilty of eight counts of failing to comply with a court order to file outstanding personal income taxes for the years 2000 through 2007 inclusive. The taxpayer was fined \$8,000 and ordered by the courts to file the outstanding returns.

The taxpayer could easily have avoided the fine and possible additional penalties by meeting

CRA's request to file. When returns are outstanding, the CRA's policy is to ask the taxpayer to file the missing returns. If the taxpayer ignores the request and fails to file, the CRA then serves a notice demanding the returns be filed. In this case it is apparent that the taxpayer did not comply and therefore charges were laid.

#### 2. Tax Preparers Sentenced

Tax preparers themselves are not immune to scrutiny by the CRA. In July 2011, the courts found a tax preparer guilty on 134 counts of tax evasion under the *Income Tax Act* and four counts under the *Tax Rebate Discounting Act*. According to court records the tax preparer claimed or obtained \$393,504 in false income tax refunds by filing fraudulent returns for 134 clients. Not only did the tax preparer have to repay the total amount of tax evaded, he had to pay a fine of \$393,504 (100% of the evaded amount) plus an additional \$2,000 on the four counts under the *Tax Rebate Discounting Act*. He was also sentenced to house arrest for two years less a day. The preparer was allowed to pay the fine in installments over five years. Failure to comply will result in a jail term in excess of two years.

The courts also found three other persons party to the scheme. Their sentences were as follows:

1. Nine months in jail and a \$286,000 fine;
2. Three months in jail, six months' probation and a \$36,000 fine;
3. Three months in jail and a \$36,000 fine.

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### **CRA investigations tie up personnel, clog the courts and cost taxpayers money.**

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#### 3. Electrical Contractor Fined

An electrical contracting company was convicted of one count of evading GST and one count of income tax evasion. The company had claimed \$379,705 in non-business expenses between 2004 and 2006 as well as construction expenses associated with building two cottages for company directors. Input tax credits for GST of \$24,007 related to the cottage expenses were also claimed as business expenses. The company was fined \$165,822, an amount equal to 200% of the total amount evaded and given one year to pay.

#### 4. Inflated Business Expenses

For the years 2005 through 2007, a taxpayer failed to offset credit notes against purchases, claimed invoices twice, indicated that personal expenses were business expenses and claimed expenses for which receipts or other documents were not available.

The cost to this taxpayer was more than \$49,000 after charges of tax evasion were upheld by the courts. The \$49,000 fine represented 80% of the federal tax evaded. In addition, the taxpayer will have to pay the taxes owed plus any interest or penalties assessed.

#### 5. False Invoicing Scheme Costly for All Involved

Three business associates cooked up a false invoicing scheme in which, over a two-year period, invoices from

Company A billed Company B for costs associated with building a personal residence for Company B's owner. Company B was then able to reduce the corporate income by \$165,000. As well, the owner of Company B failed to report the benefit received from payment of the construction cost. This resulted in tax evasion approximating \$45,000. The courts fined not only Company A and Company B but also the principals involved in the scheme. The total amount fined exceeded \$105,000. As well, the companies and principals were ordered to repay the taxes owing along with interest and penalties.

### If You Think You Might Not Be in Compliance

Chartered accountants deal with the CRA on a regular basis and find that in the normal course of business the CRA is fair when dealing with professionals and their client base. The CRA would prefer that taxpayers meet their obligations voluntarily because investigations resulting in settlements tie up personnel, clog the courts and, of course, cost taxpayers money. This is why the CRA suggests that taxpayers who have inadvertently failed to report all of their income from prior years may be able to avoid such penalties and potential jail time if they comply before any action is taken by the CRA.

If you think you may not be in full compliance with current tax legislation, ask us about the Voluntary Disclosure Program or visit the CRA website [www.cra.gc.ca/voluntarydisclosures](http://www.cra.gc.ca/voluntarydisclosures).

### *This'n That at Logan Katz*

#### Logan Katz in the Community

On March 29th Jason Valente and Yusuf Abdi spoke to a group of individuals at Invest Ottawa on preparing income tax returns, which is a must for any business, regardless of the business structure. The seminar covered the basis of preparing a tax return for two types of business structures: the sole proprietorship and partnerships.

Logan Katz is delighted to be a sponsor of the 16th annual event of Bon Appétit Ottawa, which will take place on Tuesday, May 1st. This event supports local charities which ministers towards hunger and poverty relief.

On Thursday, June 7th, the Ottawa Art Gallery is hosting its annual art extravaganza, of which Logan Katz is a proud sponsor.

#### March On-Line Poll

The Logan Katz March on-line poll asked, with the Federal Budget where would you like to see spending cut to erase the deficit by 2015. Our results revealed, 40.5 % Increase in taxes for the wealthy Canadians; 18.8% Cuts of 5 to 10 per cent per department; 15.6% Public sector job cuts; 9.4% Reduction of public pensions; 9.4% Federal politician's expenditure; and 6.3% Eliminations of social programs.