

## Safety Tips

2010 is well under way! The economy is showing signs of recovery and we are all entitled to have a positive outlook towards what lies ahead. However, we have noticed in our practice an apparent spike in the number of audits being conducted by the Canada Revenue Agency. As small business owners or management of not-for-profit organizations, we believe the odds of your entity being selected for an audit by the Canada Revenue Agency are higher than they might have been in the past. Several reasons might explain this new trend, not the least of which would be the fact the government has returned to a deficit, and one way of controlling the deficit is ensuring that taxpayers are following the rules that are set out in the Income Tax Act - and to recover taxes from those who aren't!

We thought it would be useful to provide tips and reminders that might help reduce the risks of such audits, and if selected, minimize the negative results.

### DON'T FALL BEHIND

We suggest you ensure all your statutory filings are submitted on time ... all the time. This applies to your payroll deductions at source remittances, Goods and Services Tax, Ontario Retail Sales Tax (until June 30), and of course your annual corporate tax return (or not-for-profit or charity information returns). When you fall behind, you become exposed to interest and penalties on balances owing, as well as a potential increase to the odds of being flagged for tax audits.

### KEEP BUSINESS AND PERSONAL SEPARATE

To be considered a tax-deductible expense, a disbursement has to have been incurred for the purposes of earning taxable income.

To that end, nothing is easier for a CRA auditor than detecting personal expenses claimed by a business. An auditor will feel quite satisfied with such findings and may feel compelled to dig in deeper, not to mention open up more years for audit. Such findings may also result in double-taxation where the findings are added to the individual's income AND denied as expenses in the business. Adverse GST implications will also result if Input Tax Credits have been claimed. We strongly suggest you refrain from using corporate funds to pay for personal expenses. For those areas that are grey, you will want to ensure you are positioned to provide the auditor with arguments to support your position. For example, all meals and entertainment expenses should be documented as to the business purpose and those who attended the meal. Travelling expenses claimed should also be substantiated with documentation supporting the business element.

It is critical that you have a sound understanding of all transactions that are accounted for in the company's "Due to/from shareholder(s)". If the company does pay for personal expenses, they should be accounted for here. All "credits" to this account must be understood and documented in order to provide explanations to the auditor.

If you use credit cards for payments, ensure you have a card(s) that is designated for business expenses only, and avoid using cards for a mix of business and personal consumption. Receipts must be attached to credit card statements to substantiate a tax-deductible expense and GST Input Tax Credit.

### MAINTAIN GOOD RECORDS

When entering into business or establishing an organization, it is critical to embrace the importance of maintaining sound accounting records and an organized filing system. Ensure you obtain the required training to do so, and/or hire the right service-providers that will ensure your business keeps clean records. Also ensure you keep prior years' records and documents (hard and soft copies) in case prior years are looked at. Before destroying records, you can obtain written permission from the CRA which will provide effective protection against future requests.

As indicted above, credit card statements and bank statements do not represent valid supporting documentation to back up transactions. You must keep all receipts and invoices for all disbursements whether made by cheque, credit card, or direct payment.

An inability to demonstrate sound accounting records and supporting documentation exposes you to gross negligence penalties, in addition to the standard penalties.

### UNDERSTAND THE RULES

You are in business to sell goods or provide a service that you are an expert in. It is impossible for you to know everything about everything, namely taxes and taxation. To that end, allocating the necessary resources to ensure you are being adequately advised is a good investment. Understanding the advice you are getting is essential, such as:

#### Vehicle Log

The CRA will not allow claims for vehicle expenses if you cannot substantiate your claim with a vehicle log. This document must include the starting point, destination, number of kms, and purpose of each trip, the sum of which should reconcile to your claim. Maintaining a log is a challenging habit to develop but remember that failure to do so will result in a denial or reduction of your claim upon audit.

Remember that driving to and from your residence to your employer's place of business (including a company that you own but that you're employed with) is not considered to be business-related travel.

#### Home Office Expenses

Keep in mind you are entitled to claim expenses for a home office only if your home is the main place of business or where you meet clients (or patients). If you have another area where you conduct business on a regular basis, your claim might be challenged. You should ensure the percentage you claim is reasonable and reflects the office use of your home.

These are only two examples of the many situations where you need to have a good sense of the tax rules. Maintain open dialogue with your advisors. This will ensure you are informed on a timely basis of areas where you are offside, and of the frequent changes that come up.

### EMPLOYEES vs SUBCONTRACTORS

This is an area where the CRA is very aggressive. If you have subcontractors who are not incorporated, ensure you can demonstrate they are not employees. It will be one of the first areas that will attract a CRA auditor's focus. You must ensure you understand the factors the CRA considers significant in defining the relationship between a business and its service-providers.

### TAXABLE BENEFITS

Another popular area for the CRA auditor! Ensure that taxable benefits are being captured by the company in determining the taxable remuneration earned by the employees. The use of business-owned vehicles is an obvious one. If your employees have access to employer-owned vehicles, you need to include the value of the personal use of such vehicles on their T4. Also be careful when giving gifts to employees, training, professional development, and all reimbursements. Ensure all non-taxable reimbursements are supported by expense claims and attached receipts

### IF IT SOUNDS TOO GOOD .....

Always keep this concept in mind. When something - in particular, an investment strategy - sounds too good to fly, chances are it can, and will, be challenged by the CRA. Understand your risks and the situations well before to making decisions.

### IN CLOSING

Again, from where we stand, it appears there is a spike in CRA audits of small businesses. If you are selected for an audit, we encourage you to view it as a "cost" of doing business. By following the above advice, the audit may be smooth and quick. If not, understand you are exposed to significant costs - time, taxes, penalties, interest, professional fees ... and a lot of frustration.

When contacted by the CRA, ask that all requests be made in writing and inform them you intend on cooperating completely with such requests. You are not obligated to respond to oral requests and notifications.

One last thing, keep your cool with the auditor, offer him/her coffee, cooperate, stay calm, provide the information requested, provide them with a comfortable work area - they are people who are just doing their job. If you feel you're not treated appropriately, let us know. There are mechanisms in place to ensure you are not treated inappropriately by CRA agents.

This is not meant to be alarmist. We simply wish to encourage you to ensure you follow best practices to minimize your chances of being audited and, if you are, making it as painless as possible.