



Pilgrim Accounting Inc.

PROFICENCY IN ACCOUNTING

NEWSLETTER

WHAT PROMPTS THE CRA TO AUDIT?

In the weeks following the filing of income tax returns for both individuals and businesses, many Canadians dread the arrival by mail of brown envelopes from the Canada Revenue Agency (CRA).

We believe that we handled our taxation issues properly, but we all have a tremor of insecurity when we are contacted for fear that we have been signaled out for an audit.

We can't say for sure what triggers a CRA official to set your file aside for an audit, but because of the number of clients we handle from all across Canada, we have noted certain trends over the years.

Our list of red flags that draw unwanted extra attention to your file includes forgetting any T-slip. You can't hide those things, and even if you simply misplaced it, it will come back to dog your steps. That's because the CRA has a matching program that ultimately drives all T-slips issued to their offices, and if one matches your Social Insurance Number and you didn't declare it, the trouble starts right there.

You can make an honest mistake in forgetting to declare some portion of your income, but if you do it and get caught twice within a four-year period, you can expect to be dealt with harshly.

Another issue is the small business owner who claims a lot of expenses year after year and yet gets no closer to realizing a profit. At a certain point, the CRA has to wonder if your business is legitimate.

You have to show some evidence that you can reasonably expect to make a profit in the near future, such as contracts for orders, or you may find yourself having your business plan getting a going over by the CRA auditor.

Out of ordinary expenses also wave a red flag when your tax returns are being reviewed, and the one we most commonly see is moving expenses. While there is no cut and dried rule to how much a move costs, it appears that there is a number that draws uninvited attention to you.

The same goes for motor vehicle expenses. It is expected that your car will be used for a combination of business and personal errands. If you claim an extraordinarily high amount for business, such as over 90 percent, be sure that you have a carefully kept log book that substantiates your claim. That means you have to have your daily use chronicled, where you travelled to and even who you met there, day by day. It will be checked if you are audited. If you have legitimate claims, there will not be a problem, but you will have to prove what you say.

Another red flag is when you appear to your friends and neighbours to be living a high life on a low income. If you flaunt your extravagant lifestyle, but work at a job that pays no more than \$40,000 a year, all it takes is for one disgruntled observer to call the CRA's snitch line and you may get their unwanted attention.



If you won a lottery or your parents passed away and left you a sizeable fortune, that's okay, but you have to be able to explain that to the CRA, even if you want to keep it quiet from your noisy neighbours.

How do you know if you are going to be audited? The CRA advises that one of their auditors will write to you or call you, or both, to begin the process and they will inform you of where the audit will take place.

If it is a business audit, usually it would be at your place of business.

If you have a regular onsite or online bookkeeper, they will be able to help you prepare the documentation needed for the audit.

At the end of the process, one of three things will happen:

1. The CRA will advise that no adjustments will be made to your previous assessments.
2. The CRA will advise that an adjustment resulting in more tax will be made and you will have to pay the balance owing.
3. The CRA will advise that an adjustment has been made resulting in less tax being paid and you will be entitled to a refund.

The time it takes for an audit varies. You can reduce the time it takes if your records are well-kept and you co-operate with the auditor.

Contact us for advice!

Pilgrim Accounting Inc.

Phones: (416) 514-1741, (416) 273-3663

E-mail: info@pilgrim-accounting.com

Certified professional bookkeeper and certified tax specialist Elena Ivanova is managing director of Pilgrim Accounting Inc., a national accounting and tax preparation service based in Richmond Hill, Ont. You can reach her at elena@pilgrim-accounting.com.