

Fear Factor X



It's Halloween - the time of year for scary movies, monster stories, costumes, and candy. As I reflect on Halloween, I think about the greatest, scariest business battle I have ever faced - THE 10,000LB GORILLA, aka the dreaded Revenue Canada audit - and the four different auditors I encountered (lovely people, following a very painful process).

I fought that 10,000lb gorilla for 6 months and have a few battle scars to show for it. Even though it was over 10 years ago, the memory still resonates with me. I think they call it Post Traumatic Stress Disorder; my counsellor suggested I share my experience as part of my therapy.

All kidding aside...some of the best lessons learned were simply to:

1. keep very good records of income and expenses, including the rationale behind transactions, and;
2. retain an accountant that you can work with.

The scary thing about this 10,000lb gorilla is that it can attack at any time for no reason at all. One random computer selection and BAM! you are sitting in the dreaded office preparing to defend your income and expenses for the last year or three...or four. Try remembering certain aspects of your business deductions for a four year period without proper record keeping. It's hard to justify your position to an auditor when you can't remember the why, when, where, or how.

Sort of like Rocky training to fight Apollo Creed or Ivan Drago*; staying fit for this potential battle requires serious training... daily, weekly, and monthly record-keeping; regardless of whether you are a sole proprietor, incorporated, or in a partnership.

CRA's auditors are prepared to do battle all the time. **Yes, the movie metaphors in my head seemed appropriate for this description.*

Here are some tips from my own personal experience and from conversations with tax accountants I currently work with:

TAX ACCOUNTING SERVICES

Most important....If you have trouble keeping receipts and logs, you will need help. Get it now. Find an accountant that you feel comfortable working with. They can usually provide book keeping services or provide a referral to someone for complex jobs. The billable hours you will pay now to get organized and stay organized (on your schedule) are worth it. Once CRA sends "that letter", and you have to scramble to organize multiple years of receipts, things become a lot more expensive and stressful because now you are operating on their deadlines.

REAL ESTATE: RENTALS/SALES

If your company owns real estate, make sure you don't claim capital improvements as repairs (deductible expenses). CRA will hone in on cash-intensive businesses that buy, renovate, and sell buildings because unreported cash income can be used to pay contractors under the table. CRA knows this strategy and pays close attention to cash businesses and also property transactions where there have been big cap gains in relatively short period of time.

NET-WORTH AUDIT

CRA will look to see if your lifestyle is roughly equivalent to your income and net worth. That comparison may involve estimates on your investments and other assets, especially if they include equities, whose values can fluctuate. You can't be consistently declaring low annual incomes while purchasing million dollar homes, expensive cars, and exotic vacations without a family inheritance or a big lottery win to reconcile your lifestyle costs.

INFERRED REVENUES

With cash-intensive businesses such as restaurants, CRA has taken to double-checking reported company revenues by indirect means, such as extrapolating total sales based on tip income declared by wait staff.

COMPANY VEHICLES

Make absolutely sure all trips in the company car are documented in a log—date, mileage, purpose. Only claim expenses for the business portion. Good rule of thumb:

if you only have one vehicle in your self-employed business, don't try to write off 100% of the automobile expenses as business.

MEALS, ENTERTAINMENT & TRAVEL

Keep receipts with client names and phone numbers so you can remember who you dined with and why and how it relates to your business planning and development. CRA will look for this information in the audit.

OTHER BUSINESS EXPENSES

Check with your tax accountant first to make sure certain expenses are indeed deductible to your business or profession. You can go golfing with your clients as much as you want, but golf club dues and equipment purchases are not allowable business expenses.

LOANS FROM THE CORPORATE ACCOUNT

CRA will check to see if the company is lending money to principals, and on what terms. They also want to see evidence of timely repayment; if those loans linger on the books, tax authorities will deem them undeclared income. They compare it to the personal loan base rate of bank loans. If the bank will loan money to you personally at 4%, auditors may find issues with a personal loan from the company account at 0%.

LINES OF CREDIT

For business expenses, CRA doesn't regard a credit card statement as sufficient record-keeping. If you claim the expense, you must have a receipt showing the payment and applicable sales taxes.

There it is...my take on the scary Halloween story...the scary 10,000lb gorilla that can wreak havoc on our lives if we are not prepared to fight the good fight.

These tips are by no means all inclusive and I strongly suggest you consult with a tax accountant to review your personal situation. I would be happy to provide referrals to such professionals...as part of my therapy of course. Happy Halloween!

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To have a deeper conversation about how this subject will affect your business,
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