

What to do when the tax auditor arrives

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1. For the record

The Income Tax Act requires each person who carries on a business to keep complete books and records. Your records should be up-to-date. You should have invoices to prove your expenses and your revenue. Generally you need to keep your records for six years from the time you file your tax returns. Some records have to be kept longer.

2. When the phone rings

The tax auditor will normally telephone you to arrange an appointment. Although he or she may ask to come in the next day, the department seldom expects you to say yes for a number of practical reasons.

3. Asking for an extension

If, for example, you are extremely busy in the plant or the store because of the season, or if you have a busy travel timetable and you wish to be available while the audit is taking place, ask for an extension. You will generally get it if you have a good reason.

4. Making the job easier

It may be that, like many business people, you have no detailed knowledge of the records, and you will need time to reach your bookkeeper (especially if your bookkeeper is part-time) or your accountant, to get them to gather the appropriate records together for the tax auditor. This will make the job easier for the tax auditor as well.

5. Ask questions

Ask what taxation years are being audited and, if you have more than one business, which business is under review. Usually the tax auditor will look at two or three taxation years. This will save you the cost of digging out back records that are not necessary. Tax auditors can only go back four years, unless they suspect fraud, in which case they can go back further.

6. Justifying the audit

The tax auditor will usually spend three to four days on an average small business file where the job involves two taxation years. That is general. However, the auditor could spend as little as a day or as long as several weeks. The longer they spend, the harder they will look for things to justify the audit to the supervisor. That is human nature. For that reason you want to pin down the exact taxation years and have complete records available for those years.

7. Discouraging fishing expeditions

It is very unusual for the auditor to look at records for the current year that hasn't yet been filed. Providing records for only the years under review discourages fishing expeditions.

8. Be pleasant and courteous

In dealing with the tax auditor, be pleasant and courteous. Provide an empty desk in a quiet corner. If further information is needed, have your bookkeeper obtain it. Discourage gossiping by the staff with the auditor. The longer it takes to find the information or do the work, the more pressed the auditor will feel to find something to justify the extra time.

9. You don't have to baby-sit

That does not mean you have to baby-sit the auditor. After all, you have a business to run. Customers, clients, staff or suppliers require your attention. On the other hand, you can't disappear in the hopes that your absence will somehow get the auditor to go away. He or she has a job to do, but so have you.

10. The limit should be three people

The tax auditor should limit questioning to three people—you, your bookkeeper and your public accountant. Some questions are easy to resolve. If the auditor is looking for certain invoices or cheques, etc., your bookkeeper should be able to find them. If there are questions on the business generally, you should be able to explain things. When it comes to the financial statements or tax returns, your public accountant should answer these.

11. Don't try to fake it

Depending on your timetable, the auditor should be asked to list the pertinent questions for you, and to go over them with you at the end of the day. If you don't understand the question, or if accounting or tax treatment is involved, have your public accountant answer the auditor. Don't try to explain things that you don't understand.

12. Reasons for an audit

The tax auditor is there to try to extract more taxes from you. That is his or her job. Usually your business has been chosen for a specific reason. Perhaps your travel and promotion expenses look high or your profit markup looks low. The department may be investigating the industry you are in. Loans to shareholders, tax shelter claims, unusual transactions—all these are reasons for an audit. They may be looking at your records to see if payments you made are being reported by other people. They may be checking to see if you have reported payments made by other people they have already audited.

13. Take the initiative

At the end of the audit, ask the auditor if there is going to be a change in your tax returns. Take the initiative. If you are told there are not going to be any changes, that completes the matter. If changes are to be made, get full and complete explanations of each and every proposed change. Tell the tax auditor you would like an opportunity to consider the changes and to get back to him or her.

14. Whether to challenge

Go over each change with your public accountant and decide if you are in agreement with the changes or whether the changes should be challenged. Some changes might appear small but may have more serious consequences as they may set a bad precedent for future years.

15. Standing your ground

If you feel the auditor is wrong, you and your accountant should meet with him or her to convince the department of your position. After all, you had a good reason for doing what you did on the original tax return.

16. How high to go

It may be that the auditor and your public accountant cannot agree. Arrange a meeting with the auditor's superior to convince the department that your original treatment is correct. Your public accountant will have to decide how high to go at the tax office.

17. It's important to persist

It is important to persist at the audit level. Certainly you have the right to appeal and file a notice of objection. That will mean reviewing the disagreement at a different level of the tax department with someone new. That may eventually be the only solution. However, it is far less expensive settling the matter at the initial audit level. Sometimes a compromise will satisfy both sides.

18. Points to remember

Some general points should be kept in mind. Most tax auditors are reasonable. However, if the person you have is abusive or expects your entire business to stop while you find a receipt, touch base with your public accountant to decide whether or not a change of auditor should be requested.

19. The onus is on you

On the other hand, the tax auditor has extensive powers. He or she can obtain any information to determine whether or not you are complying with the law. The auditor can look at the records of a third party to see if anything is missing. If you feel that your treatment is incorrect, the onus is on you to prove otherwise.

20. Best defenses are good records

Your main defenses are good records, logical reasons for what you did and competent tax planning. The best way to prepare for the tax auditor is by sound thinking when your financial statements and tax returns are being prepared.

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