WHAT TO DO WHEN THE TAX AUDITOR COMES CALLING

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CANADIAN FEDERATION OF INDEPENDENT BUSINESS
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If you are like many small business owners, the mere mention of a tax audit can make your hair stand on end. The important thing is to remain calm. In that spirit, here are **20 things** to keep in mind before, during and after the Auditor arrives at your doorstep. Remember, being prepared is half the battle…

1 BEFORE MEETING THE AUDITOR

1. Receiving the letter

The tax auditor will usually give notification by letter of an upcoming audit. There is a difference between an audit letter and an educational letter intended to instruct on the tax treatment of specific activities. There are two types of audit: desk audit and on-site audit. In both cases answers to specific questions will be required within a specified time period. When an audit letter is received, respond within 30 days. Don't ignore it; it won't go away.

2. Asking for an extension

If you are extremely hard-pressed for time but wish to be available when the audit takes place, ask for an extension. You will generally get it if the request is reasonable.

3. Making the job easier

Be sure to receive a detailed list of required documents and records the auditor wants to see. Like many business people you may have no detailed knowledge of the records. You may need time to reach your bookkeeper (especially if your bookkeeper is part-time) and/or your accountant to have them gather the appropriate records. This will make the job easier for the auditor as well.

4. Providing information

Ask the auditor how the requested documents or records ought to be received. They cannot be received by e-mail. To save time auditors may request documents be submitted on-line through a secure online portal such as Canada Revenue Agency's "My Business Account".

5. Keeping records

The Income Tax Act requires each person who carries on a business to keep complete books and records. Records should be up-to-date and invoices to prove expenses and revenue should be accessible. Records generally need to be kept for six years from the time you file your tax returns. Some records need to be kept longer. If certain records are no longer available, get copies from the original parties that issued them. If this is not possible, speak to the auditor about alternative methods to confirm amounts recorded.

6. Asking 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 multiple 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.

7. Justifying an audit

At a small business an auditor generally spends three to four days reviewing two taxation years. However, as little as a day or as long as several weeks may be required. Remember, the longer the time taken, the greater the search for something to justify the audit to a supervisor. This is human nature. Therefore, pin down the exact taxation years in question and have the necessary records available.

8. Discouraging fishing expeditions

It is very unusual for the auditor to look at records for the current year that haven't yet been filed.

Providing records for only the years under review discourages fishing expeditions.

2 DURING THE AUDITOR MEETING

9. Being pleasant and courteous

When dealing with auditors be pleasant and courteous. Provide an empty desk in a quiet corner or have them conduct the audit at your public accountants' office. Discourage staff from gossiping with an auditor. As stated above, the longer it takes to find the information or do the work, the more need there will be to come up with something to justify the extra time.

10. Baby-sitting not required

You have a business to run. Customers, clients, staff and suppliers require your attention. However, you can't disappear and hope the auditor will go away. An auditor has a job to do, but so do you.

11. Limiting questions to three people

Limit questioning to three people—you, your bookkeeper and your public accountant. Some questions are easy to answer. If the auditor is looking for certain invoices or cheques, etc., your bookkeeper should know where they are. If there are questions on the business generally, you should be able to explain things. When it comes to financial statements or tax returns, your public accountant should answer. Don't provide additional information beyond what an auditor needs to complete the job.

12. Explaining what you understand

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

13. Auditing small businesses

A tax auditor's job is to try to extract more taxes from you. But don't start the audit believing the tax auditor knows you have done something wrong. Usually your business has been chosen for a reason. Perhaps your travel and promotion expenses look high or your profit markup looks low. The department may simply be investigating the industry you are in. Loans to shareholders, tax shelter claims, unusual transactions—all these may be reasons for an audit. An auditor may want to look at records to see if payments made to you have been reported by other people, or check to see if you have reported payments made by others. Sometimes a business is merely selected for audit at random.

14. Taking the initiative

At the end of an audit, ask the auditor if there is going to be a change in your tax return. Take the initiative. If you are told there is not going to be a change, then that completes the matter. If changes are to be made, get a full and complete explanation for each and every one. State you would like an opportunity to consider them and then make a reply.

3 AFTER MEETING THE AUDITOR

15. Challenging choices

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

16. Standing your ground

At the end of the audit, the auditor will typically issue a letter with the proposed adjustments. You will have 30 days to respond. If you believe the auditor is wrong then you, your accountant and the auditor should meet to convince the department of your position, that you had a good reason for doing what you did on the original tax return. It is better to work with the tax auditor to demonstrate your position is valid versus trying to compromise on the amount to be paid.

17. Deciding how high to go

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

18. Appealing

Once the proposed adjustment is finalized in a notice of reassessment, you have the right to appeal and file a formal notice of objection. This will mean reviewing the disagreement at a different level of the tax department with someone new. While it may be the only solution, it is far less expensive to settle at the initial audit level and sometimes a compromise will satisfy both sides.

19. Reporting abuse

Most auditors are reasonable. However, if the auditor is abusive or expects your business to stop while a receipt is found, touch base with your accountant to decide whether to request a change in auditor. There is a Taxpayer Bill of Rights to which CRA is required to adhere in all its audits. Report any abuse to CFIB's Business Resource Counsellors to allow CFIB to raise concerns with the tax authority's senior management.

20. Proving compliance

A tax auditor has extensive powers to determine whether you are in compliance with the law. The auditor can look at third-party records, even of family members, to see if anything is missing. If you feel you have been treated incorrectly, the onus will be on you to prove your case within the time period allowed.

Defending *with good records*

Justification for action taken, competent tax planning and accessible records are your main sources of defense. The best preparation for a tax audit starts with sound thinking when readying your financial statements and tax returns. One of the best ways to ensure you have up-to-date records is to use an online secure portal like CRA's "My Business Account" to file all returns and support. What could otherwise lead to an audit may be answered by supporting documents being filed on-line.

Should you have questions,
please contact business resources at
1-888-234-2232 or **cfib@cfib.ca**