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Ali Jaffer, a Certified General Accountant at his firm AR Jaffer Professional Corp.



Elaine Pantel, a Principal at Shimmerman Penn LLP



Lior Zehetser, a Partner at Connect CPA and UFile spokesman

What are some of the most common red flags that could catch the CRA's attention?



Cleo Hamel: Sometimes there are individuals who work multiple jobs in the year, they get paid cash for one of those jobs and the assumption is: "Well, I'm getting paid in cash, I don't actually receive a T4 slip, I don't need to report it." Underreporting income is a huge problem and the CRA can detect unreported income when they do audits of

organizations.

Sometimes an audit will be on common things like people who report home offices or who use their vehicle for work and are claiming an excessively high percentage of auto or home expenses. That's going to be a red flag.

Other things include if you claim an excessive amount of a particular credit or deduction that you haven't in the past.



Lior Zehetser: There are two main types. One is when you're a business owner, if you have a lot of ups and downs or peaks and valleys, which may happen from year to year and it's perfectly legitimate, but I think it tends to raise more questions. The second thing is each year, the CRA focuses and hones in on different industries and they aggressively go after

these industries. Last year, it was people who own rental properties. It can be random or something that's trending like the condo boom over the last ten years.



Elaine Pantel: On the business side, if the business has income of over \$30,000 and they're not registered for an HST number, I see HST audits coming out of the personal tax filings.

Bruce Ball: Another common one is people claiming expenses against their employment income. Entertainment is one that they'll zero in on a bit, they'll make sure that you can justify why you've incurred entertainment expenses. Another one that comes up is car expenses. Whether it's required or not, CRA takes a hard look at

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that.

triggering a red flag.

Are there certain types of filers that tend to capture the CRA's attention more than others?



Lior Zehetser: One hundred per cent. I would say the ones that are least likely to grab the CRA's attention are salaried employees. The ones that capture the most attention for sure are sole proprietors or partnerships because they have the ability to understate income and/or overstate expenses.



Cleo Hamel: Medical is reviewed quite often. For parents with university student children, it's tuition. On the other side [are] self-employed individuals. Everything is receipt-based for them so they really are trying to ensure that someone who is self-employed is following the rules. We remind all self-employed individuals, you really have to be meticulous with

your records.



Bruce Ball: There are compliant taxpayers who happen to be in a business sector where there's a lot of underground economy, so I think those people have to be really on top [of] keeping proper records and that kind of thing because there is a greater chance of being audited. If you're in the construction business you probably need to be more careful than the average business person because they're on the CRA's radar.



Elaine Pantel: Business investors with losses. They don't come up very often, but when they do, I would say 99.9 per cent they're going to get audited.



Ali Jaffer: Donors. If you are claiming a large number of donations to a unregistered charity and you consistently do that, that could be enough for CRA to come back and flag you for future donations.



Bruce Ball: Donation claims in general [are] something they follow up on a lot because they don't know if you actually made donations or not, so they want to see a copy of your receipts and if the donation's big enough they'll ask for a cancelled cheque as well.

What are the tools the CRA uses to dig deeper into your filing?



Lior Zehetser: They compare you to people on your street, so if you live on a street where most people are earning a million dollars and you're claiming almost nothing, that also raises red flags.

They also compare across your industry. So let's say they choose to look at accountants and the average accountant makes \$100,000 and you're claiming \$20,000, they may question that.

Cleo Hamel: There are two things that the CRA does, they can do a review and they

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can do a full blown audit. The biggest difference between them generally is the review is just the CRA coming back to you and saying: "We're reviewing the return, we're noticing that there's some interesting expenses here, we just want you to provide us with a copy. If they do that and find that they are not satisfied, then the audit comes in [and] they get a little bit more meticulous and that could be the one that could be more of a problem for individuals who don't keep great records.

What should you do if you get a notice from the CRA?



Cleo Hamel: To make your life easier it's really important to follow the letter. First of all there are a lot of people who, when they get that brown envelope, get panicked and will not open them. Wrong. Whenever you get any correspondence from the CRA open the letter. You have 30 days to submit this information, you can do it in person, or you can fax it to them, they'll tell you how to accept it. Try to get it done as soon as possible.

Generally when they receive the information they're asking for in the timeframe they're asking for, you'll get a letter from them, it could take six to eight weeks, and it will say "thank you very much, there's no further action required." But not complying within the time frame and not providing the information means two things. First, they'll disallow whatever that deduction was because they're not happy with it. But if you don't agree, you can fight that — don't take their word for it.

The other thing, too, is if it doesn't go well, the next year potentially you could get asked again for the same thing. The third part would be they really don't like what you send in and they send you another letter saying 'We've decided to do a full audit on your return, we don't just want that receipt, we want all your records.'

Just because you got a refund doesn't mean that your situation with the CRA is over. You are required by the CRA to maintain your records not only for the year you file but for six years after that. You're holding on to records for seven years and that's because the CRA can go back seven years if they feel they need to.



Bruce Ball: In terms of whether they do a full audit or not, some people are unfortunate enough to just be randomly selected.

So what happens if you receive a notice, but have not kept your records, not because you are trying to be deceptive, but you're just unorganized?



Cleo Hamel: I think the CRA does have some compassion in that regard. But if you just trash them or throw them away, genuinely not realizing it, you have to go back and try and reconstruct. You have to go back to bank statements or any proof of income in and spending out.



Bruce Ball: See if you can still recreate it. It depends on how much documentation you're talking about. If it's a large donation and you just don't have the slip, go back to the charity and ask for another copy.

But if it's really big time, like you've lost all your receipts, the CRA has been sympathetic if you're able to provide secondary evidence. I think the big risk is if you don't have your receipts, they're not going to allow you your tax deduction.



Ali Jaffer: It all depends on the auditor that you get. Some auditors are a little more flexible, like they'll allow credit card statements and some, they need the actual receipt.

Bruce Ball: It depends on everything that you do as a taxpayer. If you're just missing



one small part, they're more likely to give you a break on that because you're otherwise a compliant taxpayer.

What is the best course of action once you've been flagged?



Cleo Hamel: Everyone at some point is going to get a review letter. Open the letter, read it, you'll be fine. As long as you follow the rules you have nothing to worry about.



Lior Zehetser: I'd say the first thing is to be nice to them. [Try not to lose your] temper or snap, because once you do, they think, 'Hey, why is he or she getting mad? Maybe there's something wrong.'

They're not going to go away, once the letter is sent they will keep following up until you answer and until the case is closed. They won't leave you alone until you provide them with what they want.

If you don't feel comfortable then go to an accountant. It may cost you, but it will cost you less than what it would cost if you were on your own.



Elaine Pantel: Deal with the emotional aspects of being audited and either speak to a professional or take your time and sit back and really answer what it is they're asking for, rather than getting too nervous about it.

Part of the problem comes from the taxpayer not responding and maybe it's because they're anxious and nervous, but one of the best pieces of advice I have is communicate and cooperate as best you can. It's about being proactive and let them believe you at least tried your best to put together something for them.

Do you have any horror stories or cautionary tales about dealing with the CRA? Share them with us in the comments below.

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