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The Taxman Wants What?

Computer technology has been a great boon for the Canada Revenue Agency (CRA). Simple slips such as T4s for employment income or T5s for investment income are now on the CRA system and can be matched to the return you filed. As well, as more and more of us e-file our personal tax returns each year resources that previously were used to input returns or check mechanical accuracy are now used to do “desk” or simple audits.

A desk audit is generally one in which you or your accountant receives a letter from the CRA requesting that you submit receipts to support an expense or deduction claim. The following is a list of many of the items that the CRA focuses on when assessing a personal tax return which may result in a request for additional information or copies of receipts.

Copies of cancelled cheques can substitute for receipts but it is always better to have the original document.

The simple items

Professional or union dues – when you get that membership card from your union or professional association it usually includes a receipt for the amounts paid. In a pinch you can send the card and your cancelled cheque but it is better to ensure you keep that receipt.

Child care expenses – these are very commonly requested. If you are paying child care to an individual it is very important to ensure that you have that person’s Social Insurance Number (SIN). Cancelled cheques are generally adequate support but it is best to put the child’s or children’s name(s) and the period for which payment is being made in the memo field on each cheque. If you have a nanny or housekeeper the T4 can act as support for your claim.

Child care organizations do provide regular receipts for all payments. Always remember to keep receipts for summer day or overnight camps as these are also deductible.

Tuition fees – Although it appears that the CRA has changed its policy and no longer requires that these receipts be submitted with your tax return, this type of information is consistently requested. For Canadian educational institutions you will be required to submit a T2202 received from the institution and when tuition is paid to an educational institution outside of Canada Form TL11A should be attached. Careful attention should be made when tuition is being transferred to ensure that the student completes and signs the “Designation for the transfer of an amount to a spouse or common-law partner, parent, or grandparent” section of the form (Back of T2202).

More complicated requests

Disability tax credit and medical expenses - We have combined these two into one as they may be inter-related, especially when it comes to claims for nursing home expenses, full-time attendant costs and other medical expenses. All medical receipts must be submitted when filing the return but the rules are very complex in terms of when the disability tax credit may be claimed, and whether one may also claim attendant care expenses or nursing home expenses or both. When making an initial claim for a disability tax credit, Form T2201 must be completed and signed by a licensed medical practitioner

Employment expenses - Individuals who are not self employed are very limited in the nature of expenses that may be deducted from employment income. Upon receipt of Form T2200 signed by the employer, certain expenses such as automobile and home office expenses may be deducted. Receipts do not have to be submitted with the return but must be available for review if ever questioned by the CRA. I recommend that a proper log book be maintained to support claims for automobile expenses as this is always an area closely scrutinized by the CRA.

Moving expenses.- Many taxpayers do not take advantage of a potential claim for moving expenses, but the ones that do invariably receive a request for further information. Form T1M must be completed when filing your return, however the corresponding receipts need not be submitted at that time.

Business or rental income/losses - The CRA has become more aggressive in the past few years with reviewing, in detail, business, professional and rental statements included in the tax return. They specifically seem to focus on situations where businesses or properties consistently report losses or where there are large claims for business expenses and a personal element might be included. It is important that all expenses claimed directly relate to the income being earned and, if requested, all receipts and invoices must be made available to substantiate the claims made.

Allowable business investment losses (ABIL) - In certain instances, loss or decline in the value of investments in small business corporations, such as an investment in shares or a shareholder loan account, may be claimed as an ABIL but it's almost a certainty that the CRA will request supporting information relating to the claim. It is recommended that this information be included in the return when filed.

Carrying charges - The concept of interest deductibility is ever evolving and very complex, but our experience has been that the CRA is becoming much more aggressive in requesting detailed supporting information with respect to how the borrowed funds were used, copies of all loan documentation, and substantiation for the interest expense claimed.

Foreign income reporting 1 - Residents of Canada are required to report all sources of worldwide income whether or not tax is paid on that income in another jurisdiction. Generally, foreign tax credits can be claimed to offset the potential double taxation which would occur when income is again taxed in Canada. To claim a foreign tax credit, the CRA requires documentation substantiating the payment of tax in the foreign jurisdiction.

Foreign income reporting 2 - Canada has recently extended its relationships with other tax jurisdictions in terms of communication and compliance as well as imposing severe penalties for failure to report foreign income. Page one of the personal tax return includes the question "Did you own or hold foreign property at any time in the year with a total cost of more than CDN \$100,000". Certain property is excluded from the total but if the answer to the question is yes, Form T1135 must be completed.

Conclusion

The preceding does not include documents that are normally filed with a return, such as donation receipts. If you are e-filing return than you may be required to produce any paper work that the CRA requires to support your income and expense claims. This type of CRA assessment policy request is quite common.

It is also important to note is that each taxpayer should maintain a proper and effective record keeping system, as the onus is on him or her to provide support if requested. Copies of all documents and receipts supporting income or expense amounts included in returns should be kept in an orderly fashion to avoid any potential problems down the road.

This report is presented as a source of general information only and has been prepared based on information from various sources. Every effort has been made to ensure the accuracy of the information but this article it is not intended as a substitute for competent professional advice tailored to the individual reader's particular circumstance.

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