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The CRA "Top Ten"

CRA audit *(Sandy Cardy)*

We often get asked the question, "What items are most likely to be audited by the Canada Revenue Agency (CRA)?" Although we would all like to know the answer to that question with certainty, it is one that is notoriously difficult to predict; however, Deloitte & Touche LLP recently compiled a list of items most likely to be questioned on tax returns. This information, obtained from their practitioners across the country, was based upon their collective experience with thousands of personal tax returns.

The CRA "Top Ten":

1. *Allowable business investment losses (ABIL).* The ABIL takes the top "frequently audited" position. Losses in relation to debt or equity of small business corporations are subject to detailed rules and are carefully scrutinized. Most taxpayers claiming an ABIL soon receive a standard form letter from the CRA requesting additional information. Consequently, it is prudent to analyze the validity of a claim carefully and compile the supporting documentation prior to filing the personal tax return.

2. *Medical expenses.* An aging population puts a strain on our health care system and also on the tax system. Be prepared to document and support medical expense claims, which are one of the most frequently questioned aspects of personal tax returns. The issue commonly arises where an individual moves into a nursing home and his or her medical expenses increase dramatically.

3. *Carrying charges*. Expenses incurred to earn investment income, such as interest and management fees, are frequently challenged, even when the amounts are fairly modest. It is critical to retain supporting documentation and ensure that personal expenses are not intermingled with tax-deductible items. New draft legislation in relation to interest deductibility may keep this topic near the top of our list for a while.

4. *Stock option deductions and deferrals.* The CRA frequently seeks clarification of an individual's entitlement to the stock option deduction. Often, a letter from the employer is sufficient to address this concern. On a related note, the election to defer tax in relation to a stock option benefit is also commonly questioned, particularly the issue of whether the election was, in fact, filed.

5. *Province of residence.* The status of Alberta as a tax haven of sorts within Canada has apparently led too many individuals—generally those previously resident in the adjoining provinces of British Columbia and Saskatchewan—to claim Alberta residence. The CRA has been aggressive in challenging this position and the related leakage of provincial tax revenues. In fact, there is a special project under way to review the status of taxpayers who have historically filed as BC residents and subsequently changed their filing position to claim Alberta residence.

6. *Charitable donations.* Large donations (in excess of $25,000) and donations of property in kind continue to attract scrutiny. This attention is likely the result of the multitude of "structured" or "leveraged"

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donation schemes developed over the last few years prior to the recent introduction of legislation to shut them down. There is a perception that charitable donation tax credits have been abused, thereby warranting additional scrutiny.

7. *Instalments.* Problems with instalment payments continue. In many cases, the payment is credited to the calendar year in which it is made, rather than to a prior year to which the taxpayer has requested payment be directed. The result is an unexpected shortfall in respect of a particular year and a credit for another year.

8. *Disability tax credit*. Eligibility for the disability tax credit is very strictly defined by the tax legislation. Supporting documentation from a medical professional is critical.

9. *Rollovers from deceased individuals*. The income tax on registered accounts (RRSPs, RRIFs) held by a deceased individual can be deferred when a surviving spouse is the beneficiary. The amount is generally reported with an offsetting deduction. Although this transaction is fairly routine, it is invariably questioned.

10. *Business expenses with a personal element.* It is important to segregate personal items from legitimate business expenses as only the latter are deductible for tax purposes. There have been many questions from the tax authorities when a particular expense combines a business component with an element of personal benefit—for example, when a spouse is invited on a business trip or when accurate mileage records are not maintained for an automobile with personal and business uses.

This should not be construed as legal or tax advice, as each client's situation is different. Clients should consult their own legal or tax advisor.

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