CRA targeting unregistered, small-town contractors in tax evasion crackdown

JULIUS MELNITZER | July 12, 2016 12:39 PM ET
More from Julius Melnitzer

Republish
Reprint

CRA investigators reviewed lists of municipal building permits in smaller communities to check on worksites for unregistered small-town subcontractors. Sam Hodgson/Bloomberg

The Canada Revenue Agency's continuing campaign against the underground economy has come to roost in small-town Canada, where special audits have confirmed the pervasiveness of tax evaders in the construction industry.

"This is all part of a CRA focus on the underground economy that has been a priority for several years, ever since the construction sector was identified as being of particular concern for unreported income," says David Rotfleisch of Rotfleisch & Samulovitch Professional Corp. in Toronto.

In a special tax audit, CRA investigators recently reviewed 8,396 municipal building permits, The review identified 2,751 unregistered building contractors from whom the CRA collected some $4.5 million in taxes.

Tax investigators also targeted installers who work for hardware and home improvement stores. The audit of 93 hardware stores in 19 different communities found that seven per cent of installers were income tax evaders, from whom the CRA collected some $4.5 million in taxes, $559,000 in interest payments and $843,000 in penalties.

The CRA's methodology in these cases, Rotfleisch says, is both interesting and unusual: "What we're seeing is out-of-the-box thinking by CRA that is very clever."

Related

There's a hidden cost to Canada's underground economy, worth a staggering $45.6 billion

Canadians spending more on fixing homes than buying new ones as renovations top $68 billion

Computerization and data mining are aiding the underground economy initiative.

"It used to be that CRA had to grind through the numbers manually," says William Innes of Rueters LLP in Toronto. "But now there is a great deal of computerized data that allows them to deal with tax evasion more easily."

It's all part of a strategy in which the CRA has increased the use of third-party information to detect underground economy activity. In an email, CRA spokeswoman Jelica Zdero said the third-party approach yielded $10.8 million in taxes, $1.5 million in arrears interest and $2.1 million in penalties in the 2010/11 and 2012/13 taxation years.

The CRA has targeted several industries.

More recently, it has resorted to casino audits as an indirect way of assessing individuals' income and net worth.

"The Agency is looking at casino records to identify heavy gamblers, then auditing them to see whether their reported income is capable of supporting their gambling habits," Rotfleisch says.

Taxicabs have also come under scrutiny by way of indirect audit verification, Rotfleisch adds. "The auditors work back from gasoline purchases to determine the miles driven, and then calculate how many of these miles have been reported."

CRA investigators are examining restaurants' food and liquor purchases, determining an "average cost per meal," then adding notional markups to determine what actual sales should be.

Even waiters and waitresses have come under the microscope. Several years ago, an investigative blitz involving some 150 wait staff in various restaurants in St. Catharines, Ont., revealed that the vast majority were under-declaring their tips.

What we're seeing is out-of-the-box thinking by CRA that is very clever.

The CRA's underground economy strategy is constantly evolving. In November 2014, the agency announced an updated strategy for its fight against the underground economy.

"As risks change over time, the CRA continually refocuses its efforts based on emerging risks," Zdero said.

By way of example, auditors have cracked down on "zapper" software that can produce auditable records that eliminate reportable transactions from point-of-sale systems. In 2015-16, the CRA assessed approximately $8.5 million in income tax and GST/HST as a consequence of investigations involving what it calls "electronic suppression of sales" software.

Still, Rotfleisch cautions that indirect audits can produce misleading results. He cites the case of a taxi driver who lived in Hamilton, Ont., had a Toronto license, and had family in Kingston. "Working back from the gasoline purchases produced incorrect assessments here, because this individual had substantive non-chargeable use of his vehicle."

The indirect method also resulted in false conclusions in a case involving a restaurant. "The CRA failed to take into account that this particular restaurant used alcohol extensively in its food recipes and therefore grossly underestimated the food costs," Rotfleisch says.

Rotfleisch also says that the methodology the CRA uses in its casino audits can be flawed. "The Agency's methodology has assumed that the money gambled from time to time is a cumulative sum, where in fact it may be money that has been turned over through winnings and losses."

Perhaps the best known use of the indirect audit is the "net worth" assessment.

"In these cases, the CRA takes snapshots of two taxation years, and if it sees a substantial increase that is unexplained, it treats the increase as undeclared income," Rotfleisch says. "But that doesn't take into account such things as inheritances, borrowings or offshore remittances to immigrants from families back home."

Taxpayers can, of course, challenge incorrect assessments. But even those at risk because of undeclared income or unfiled returns can mitigate the potential penalties through voluntary disclosure.

"By disclosing before CRA auditors target them, taxpayers can avoid tax evasion prosecution, tax penalties and often benefit from an interest reduction on unpaid taxes," Rotfleisch says.

Topics: **Legal Post**, **Taxes**, **Canada Revenue Agency**, **Construction Law**, **Tax Law**