

## TAX TALK

# Tales from tax court

*There are lessons to be learned from others' mistakes*

You want to learn from your mistakes, but it's way more fun (and far less painful) to learn from the mistakes of others.

That's why it's instructive to read Canada Revenue Agency's police blotter of tax-fraud convictions, which the agency posts on its Web site.

Mind you, these people didn't make mistakes as much as they cheated and got caught. But there are lessons to be learned from their transgressions, especially as we head into a new tax year and toward that April deadline for filing your 2011 personal return.

## Two books, big problem

In an age-old scam, Miles Derco of Winnipeg and his repair shop, M.J. Dominion Transmission, kept



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two sets of books: one each for cash and non-cash transactions. An audit showed that for cash transactions, Derco used a receipt that had the same receipt number as an unrelated non-cash sale but he never reported those cash sales as business income. GST was also under-reported by omitting those cash sales.

Derco and the business pleaded guilty to three charges of tax evasion and were fined a total of \$140,000.

What can you learn from this scam artist?

First, CRA requires you to keep

accurate and complete income and expense records. That means recording income when it's earned and expenses when they're incurred (the accrual method is what you should be using, not the cash method). Not sure? Ask!

Second, working for cash will bite you in the end. The combination of low income and a rich lifestyle is a huge red flag for an auditor, who will dig into your personal and business bank accounts, credit card transactions, and other financial records to see how you're able to pull that off.

## Not your personal cookie jar

Two recent convictions are reminders to keep business and personal transactions separate.

Auditors determined that Transport Rolland Menard of Laval, Que., failed to report \$735,342 in business income after they found most of this money in a bank account with no record of it on the business's balance sheet.

They also discovered that the company's administrator, Guy Menard, kept business income of \$763,993 as his own and failed to declare it on his personal income tax returns. Menard may not have reported these deposits, but you can bet that his bank did.

The company and Menard pleaded guilty to tax evasion and were fined \$139,313. Menard was also sentenced to three years probation.

At Brothers & Wright Electrical Services Inc., CRA auditors found that the company claimed \$379,705 in construction expenses to build personal cottages owned by the corporation's directors. The company pleaded guilty to one count of evading GST and one count of federal income tax evasion. It was fined \$165,822 – twice the total amount of tax evaded – plus \$24,007 of input tax credits for GST related to these expenses.

Whether it's mileage for a service vehicle or office supplies that end up in the kids' school backpacks, a tax auditor wants to see that the expenses you claim were incurred to earn business income.

## It's your return

Auguste Christiane Frederich von Pfahlenburg-Marienburg ran a tax-preparation company in Vancouver. Besides having a name long enough to need both sides of a business card, Pfahlenburg had such an uncanny ability to lower his clients' tax bills that a suspicious competitor complained to the CRA.

The agency determined that between 2003 and 2007, Pfahlenburg overstated or invented business expenses on the income tax returns of 18 clients. He was sentenced to three months in jail and fined \$41,484 after pleading guilty to one count of income tax evasion.

Clearly, Pfahlenburg is the bad guy here. But 18 clients had fraudulent returns filed (they all said they were unaware of Pfahlenburg's actions). Presumably, those clients also had their returns adjusted and had to pay the tax they owed plus interest and penalties.

You are responsible for the accuracy of your tax return no matter who prepares it. Leave time to check the paperwork once it's returned to you. If it doesn't look right, ask questions. "I forgot" or "I didn't know" won't fly in court.

## Do it right

After years of working with clients in the trucking industry, I can tell you that the owner/operators who do things the right way always have something to show for their efforts.

Start the year by making sure your invoices, income slips, bank statements, and receipts are in hand. With a clear income picture, a good accountant who knows your business can point out all the credits, deductions, and exemptions you're entitled to take while minimizing the risk of an audit. Or worse, a trip to tax court. □

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