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Tax

Hasty shredding of tax records can bring serious penalties

By AdvocateDaily.com Staff

While it is a commonly held belief that tax records only have to be kept for six years, the question of when to dispose of documents and which ones can be purged is more complex than it appears, Toronto tax litigator Adrienne Woodyard writes in *Lawyers Weekly*.

"This complexity is due to the broad language in the Income Tax Act (s. 230). It requires taxpayers to maintain all 'records and books' necessary to determine and verify their taxes payable, and any other amounts required to be deducted, withheld or collected," explains Woodyard, a partner with DLA Piper (Canada) LLP.

While the general rule is that all records which meet the "tax determination purpose" test must be kept until six years after the end of the taxation year to which they relate, Woodyard says this does not mean that taxpayers and businesses whose fiscal periods ended on December 31 are now free to shred records from pre-2010.
Tax records, she cautions, must often be retained past the six-year period, and sometimes even for decades.

"If a tax return is filed late, the retention period will not expire until six years after the return is filed. If an issue is under objection or appeal, the records pertaining to that year must be kept until the objection or appeal is disposed of. This can sometimes take years; thousands of taxpayers who claimed controversial charitable contributions throughout the 2000s are not yet free to dispose of their records because their cases are still working their way through the system," writes Woodyard.

Woodyard also notes that taxpayers who engage the services of an accountant, lawyer or other professional often assume that these advisers bear the responsibility for maintaining these records. She recommends that advisers clarify in writing that it is the client who bears the responsibility and cost for long-term record storage.

The bottom line, says Woodyard, is that taxpayers who fail to provide records to the CRA face serious potential consequences.

“Taxpayers typically bear the onus of proving that their tax returns are correct, and countless Tax Court cases have been abandoned or dismissed due to insufficient documentation,” she explains.

“In addition to compromising a taxpayer’s ability to defend a filing position, failure to maintain records may prompt the CRA to order the taxpayer to follow specific retention instructions. Failure to comply can result in summary conviction and a penalty of up to $25,000.

"Records are generally required to be kept at the taxpayer’s place of business or residence in Canada. Given the challenges associated with physical record retention, many taxpayers prefer to store their records electronically, which is permitted by the Income Tax Act. However, many assume that the location requirement will be met if files are stored on servers outside Canada, as long as taxpayers can access the files from Canada,” writes Woodyard.

The CRA still maintains that permission must be given before records can be stored outside Canada, she adds.

Ultimately, Woodyard suggests that there is a need for taxpayers to implement a records retention policy that will not leave them vulnerable in the event of an unexpected audit.