TAXTALK

KEEPING YOUR RECORDS STRAIGHT:

A Primer for Maintaining Proper Tax Records

Maintaining proper books and records is not only good practice, it is also essential.

Everyone in business must keep records. Good records will help in the following areas:

- Monitoring the progress of a business;
- Preparing financial statements;
- Identifying income sources;
- Preparing a list of tax deductible expenses;
- Preparing a list of equipment and property purchases;
- Preparing tax returns; and
- Preparing support for items reported on tax returns.

Consider the case of the following Ontario businessperson. In 2009, he was charged with failing to keep proper books and records as required under tax legislation. He pleaded guilty in court, and was fined an astonishing amount of $16,500[1].

As the businessperson realized the hard way, Canada Revenue Agency ("CRA") has extensive powers to inspect your books and records and other documents in the course of conducting an audit, and to issue requests or demands for information. This allows them to facilitate tax administration and enforcement.

Nevertheless, it is easy to keep books and records that meet CRA requirements, and this could prevent you from facing legal repercussions as experienced by the above Ontario businessperson.

This TaxTalk will discuss the record keeping requirements of taxpayers.

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Record Keeping Requirements

Generally, the following must keep books and records:

- Individuals who are required to pay or collect taxes, or are carrying on a business;
- Corporations that are required to pay or collect taxes, or are carrying on a business;
- Trusts that are required to pay or collect taxes, or are carrying on a business;
- Registered charities;
- Registered Canadian amateur athletic associations; and
- Non-profit organizations.

In tax, the definition of "record" is surprisingly broad. It includes accounts, agreements, books, charts or tables, diagrams, forms, images, invoices, letters, maps, memorandums, plans, returns, statements, telegrams, vouchers, and essentially *anything* that contains information, whether in writing or in any other form.

[1] *Canada Revenue Agency News Release, "Not Keeping Proper Books and Records Costly for Markham Businessman", September 28, 2009*.

To further complicate matters, the CRA does not specify what records you need to keep. So where do you start?

Fortunately, there is a rule of thumb. As ironic as it may sound, your tax records should adhere to the "**SCRAP**" principle. In other words, they should be:

- **Supported by source documents** (invoices, receipts, etc.) to verify information contained in the records;
- **Complete**;
- **Reliable**;
- **Additional documents** that assist in determining your tax liability and entitlements; and
- **Providing correct information** needed to fulfil your tax obligations and calculate your entitlements.

You need to keep orderly records of all income received and expenditures incurred. Outlays include salaries and wages paid, operating expenses, capital expenditures, and miscellaneous items (such as donations).

Example:
Darlene imports goods into Canada. To meet CRA standards, Darlene's records must substantiate the price that she paid for the imported goods, and list their origin and description. They must also include any documentation about the reporting, release and accounting of the goods, as well as the payment of duties and taxes.

You are at liberty to determine on your own what books and records you require, but those books and records created, maintained and retained must contain enough information in sufficient detail so that it meets the tax determination standard.

In addition, whichever accounting or record keeping method you use, CRA requires that your source documents that support your records must be permanent and you must not be able to alter those documents at any time in the future.
You may scan into electronic format original paper source documents and you may then dispose of the original documents and keep the electronic scanned documents as the permanent supporting documents.

The accounting records must also contain a systematic account of your income, deductions, credits, and other information you used to report on your returns.

Electronic Records

Any information that you record in an electronically readable format can be used as an electronic record for tax purposes.

However, not all documents are necessarily saved in an "electronically readable format". It must be information supported by a system that can produce an accessible and useable copy. In simple terms, "accessible" means electronically readable on CRA equipment and "useable" refers to CRA being able to process and analyse with CRA software. If the files are encrypted or stored in a backup format, you must be able to restore them to an accessible and useable state to meet CRA requirements.

Electronic record keeping may be applicable if you use electronic business systems to create, process, store, maintain and provide access to the financial records.
However, you are not relieved of the record keeping responsibilities simply because you contract out the record keeping function to a third party (e.g. an accountant, bookkeeper, Internet transaction manager, or other arrangements).

Where electronic records are kept, the CRA may review the business systems to understand the information flow, evaluate the reliability of internal controls and identify data files that will be required. Therefore, it is critical to be able to provide documentation describing the operating and business systems, and to show an audit trail recreating a sequence of events related to a business transaction.

Where Can Records Be Kept

Records must be kept at the place of business or residence in Canada, unless the Canada Revenue Agency (CRA) gives permission in writing to keep them outside of Canada.

Records kept outside of Canada and accessed electronically from Canada are not considered records kept in Canada.

The CRA will not give permission to keep records outside of Canada to the following:

- registered charities
- registered Canadian amateur athletic associations
- Canadian municipalities
- public bodies performing a function of government
- housing corporations resident of Canada and exempt from tax under Part 1 of the Income Tax Act

A written request must be made to a Tax Service Office to obtain permission to keep records outside of Canada. The CRA will provide written permission after a review of the situation. The CRA's written permission will specify any terms and conditions that must be met in order to keep the records outside of Canada.

If the CRA gives permission to keep the records outside of Canada, the records must be made available upon request in Canada for review by the CRA.

If so, the CRA may accept copies if:

- the CRA is satisfied that the copies of the records are true copies;
- the records are made available to CRA officials in Canada in an electronic format readable by CRA software; and
- the records show enough details to support the returns filed with the CRA.

If the records are kept on servers located outside Canada, CRA staff must have access to the servers and be able to provide the electronic system records required by CRA officials.

Records kept outside Canada and accessed electronically from Canada such as cloud services are not considered to be records kept in Canada and thus a written request from CRA must be obtained.

However, where the records are maintained electronically in a location outside of Canada, the CRA may accept a copy of the records, provided the copy is made available in Canada in an electronically readable and useable format for CRA and the copy contains adequate details to support the tax returns filed with the CRA. In this case, CRA does not require written permission, since they consider the records to be kept in Canada.

Benefits of Keeping Records

While there is the underlying statutory requirement to keep records, there are also a number of benefits for you.

1. *Identify income sources:* You may receive cash or property from many different sources. If you do not maintain records showing your income sources, you may not be able to prove that some sources are non-business or non-taxable. For instance, on a net worth assessment, CRA could assert that all receipts are revenue that are taxable, even if some of the receipts were repayments of loans which are non-taxable.
2. *Save taxes:* Good records serve as a reminder of deductible expenses and tax credits. If you do not record your transactions, you may forget some of your expenses or tax credits when you prepare your tax returns.
3. *Prevent problems during audits:* If your records are so incomplete that auditors cannot determine your income from them, the auditors will have to use other methods to establish your income. These additional methods by CRA will lengthen the time of the audit and will require you to spend more time obtaining additional details to support your position. If your records do not support your deductions, the deductions could be disallowed by CRA.

Retaining and Destroying Records

Different jurisdictions have different retention requirements.

The federal income tax act, excise tax act and employment insurance act require you to retain records for at least six years from the end of the last tax year to which they relate.

Businesses operating in Ontario cannot destroy records related to the business' fiscal year that ended less than seven years before the beginning of the fiscal year in which you plan to destroy the records.

The Ontario Workplace Safety and Insurance Act does not say how long employers are required to retain employment records, however, the Employment Standards Act requires you to retain wage records for at least three years after the employment ends. Since, these are both Ontario government acts that relate to employment, three years should also apply to the Workplace Safety and Insurance Act.

A practical solution where different jurisdictions that have different retention requirements is to use the longest retention period. We have provided a summary of record retention periods for businesses in Ontario in Appendix A.

If you filed your income tax return late, you must keep your records and supporting documents for a period from the date you filed the late return. The minimum period for keeping books and records is usually measured from the last year you used the records, not the year the transaction occurred or the record was created.

Example:
Philip bought restaurant equipment in 2009 and sold it in 2011. Even though the records relating to the purchase of the equipment were created in 2009, Philip needs them to calculate the gain or loss on the sale in 2011. Therefore, Philip must keep the 2009 records until 2018.

For objections and appeals, you must keep all relevant books and supporting records until they are resolved and the time for filing any further appeal has expired, or until the seven-year period mentioned above has expired, whichever is later.

Request for Early Destruction

If you wish to destroy any of your books or records before the required period is up, you must apply in writing to the director of the tax services office in your area to obtain written permission from the Minister of National Revenue. To do this, either use Form T137, *Request for Destruction of Books and Records,* or prepare your own written request.

In addition to the requirements of CRA, there are other federal, provincial, and municipal laws that require you to keep books and records. CRA has no authority to approve destruction of books and records that these other laws require you to keep.

Other government agencies, such as the Workplace Safety and Insurance Board, or Employment Insurance, will have their own rules, which again differ from CRA and also require permission for early destruction.

As there are many federal, provincial and municipal government offices that may have an interest in your books and records, and as penalties can apply if records are destroyed too soon, a prudent course of action is to obtain approval from the appropriate authorities before destroying records.

Permanent Records

Certain corporate records are permanent and cannot be destroyed until two years after a corporation is dissolved. These records include:

- Minutes of meetings and resolutions of directors and shareholders;
- Share register;
- General ledger (or other book of final entry); and
- Any special contracts or agreements necessary to understand the entries in the general ledger.

Each business corporation act has similar rules in this regard. For instance, the *Ontario Business Corporations Act* requires a company incorporated under it to maintain certain records (which may be requested up five years after dissolution), including:

- Articles of incorporation;
- Corporate by-laws;
- Copy of unanimous shareholder agreements;
- Minutes of meetings and resolutions of directors and shareholders;
- Securities (share) register; and
- Directors' register.

Please refer to **Appendix A** for a list of records and the requisite retention period in Ontario.

Security

In addition to maintaining appropriate records, you should consider whether or not your records are secure. Specific issues include:

- **Sufficiency of controls:** Are they in place to maintain confidentiality of information? Are you able to protect the privacy of your financial information and the personal records of your employees?
- **Physical security:** Do you have preventative measures in place such as fireproof safes, locked premises, or methods of backing up electronic information? Are there recovery procedures in place, such as offsite storage, and procedures to follow in the event of a loss of records?
- **Unauthorized data:** Are sufficient controls in place to ensure unauthorized data does not enter the system? Are there checks in the system to recognize and exclude unauthorized data? Has an evaluation on the likelihood of cyber risks including hacking, malware, phishing, ransomware or spam been performed? Are the records protected from a Cyber-attack by the use of cyber security processes?
- **Accuracy and completeness:** Is the information processed accurate and complete? Is the system tested regularly and monitored to ensure that transactions are processed as expected and the final product is based on complete and accurate information?

Conclusion

Good record keeping is a critical success factor for any business or taxpayer. CRA's powers to require you to keep records and supply information are extensive. It is essential that you review your record keeping and retention methods and ensure that you have updated record management practices that will provide the greatest possible control of tax-related information, whether in paper or electronic form.

The discussion above provides an overview of records that need to be kept in order to satisfy CRA and to substantiate that your income and expenses are fairly recorded.

APPENDIX A

Record Retention Periods in ***Ontario***

Permanent (until five years after dissolution)

Articles of incorporation
Copy of unanimous shareholder agreements
Corporate by-laws
Correspondence (executive and legal) *
Debenture register
Directors' register
General Ledger
Insurance: * Policies (including expired ones)
Accident reports
Minutes of meetings and resolutions of directors and shareholders
Share (securities) register
Tax returns and other documentation relating to the determination of income tax liability

Ten Years **

Correspondence (general)
Employee personnel records after termination of employee

Seven Years

Accounts payable ledger
Accounts receivable ledger
Bank reconciliations
Bank statements
Bill of sale
Cash receipts and disbursements journal
Cancelled cheques ***
Capital asset acquisitions ***
Contracts and leases ***
Deeds ***
Duplicate deposits slips
Expense analysis and expense distribution
Insurance, claims (settled)
Inventory schedule
Invoices to customers and supporting documentation
Invoices from suppliers and supporting documentation
Mortgages ***
Payroll records and summaries
Petty cash vouchers

Notes

* Although the required retention period is seven years (or less), it is recommended these records be maintained permanently due to their nature. Executive correspondence includes correspondence of groups and staff reporting to executive positions.

** It is recommended these records be maintained for ten years despite the fact there is no legal requirement to keep general correspondence, and payroll records need only be maintained for three years after the termination of an employee.

*** For transactions of an enduring nature such as the acquisition of an asset to be used over a number of years or a lease (or other contract) spanning several years, the related documentation must be kept for seven years **after** the disposition of the asset or termination of the lease. A copy of the cancelled cheque relating to the transaction should be attached to the documentation.

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