

Tax

Registers and arbitrary tax audit methods

By Jonathan Éthier



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(April 17, 2020, 11:06 AM EDT) -- The *Tax Administration Act* subjects anyone who carries on a business or is bound under a fiscal law to deduct, withhold or collect an amount (e.g. the Quebec Sales Tax or QST) to an obligation to keep registers. The notion of a "register" is very broad: any document, whatever the medium used (e.g. paper, electronic format), that is used to collate information in particular for accounting, financial, fiscal or legal purposes, must be kept.

As a general rule, the registers and their supporting documents shall be preserved for six years after the last year to which they relate. For example, for an individual in business, a receipt in support of a current expense dated Feb. 1, 2020 should be retained until Dec. 31, 2026.

Revenu Québec auditors are specifically authorized to examine taxpayers' documents and registers. They should be able to corroborate the income reported. In the absence of records or supporting documents, an auditor could rightly opt for an alternative or indirect method of audit to reconstruct a given taxpayer's sales and income for tax purposes, since the minister is not bound by the information provided by taxpayers.

At the very least, the method used should be sufficiently reliable, albeit arbitrary.

In *Alertpay Incorporated c. Agence du revenu du Québec* 2020 QCCA 46, the Quebec Court of Appeal recognized that Revenu Québec had been justified in establishing the income of a corporation using an alternative method because of the manifest inaccuracy of the financial statements, the lack of co-operation of the corporation and its sole shareholder/director and the absence of credible explanations from the latter. The income had been reconstructed on the basis of the shareholder's public statements on the corporation's turnover.

In this case, the amounts assessed at the corporate level had also been added to the shareholder's income as appropriation of funds. The Quebec Court of Appeal noted that the following elements were sufficient to conclude that the shareholder had appropriated the funds of the corporation: a) the corporation had generated undeclared income with respect to the years in dispute; b) the income was not included in the financial statements and no reasonable explanation had been given; and c) the individual was the sole shareholder and director of the corporation and had full control over it.

An individual contesting an assessment issued to him or her as appropriation of funds should put in evidence figures or provide justifications that make sense, even though the amounts added to his or her income could be the result of a corporation's arbitrary assessments. In fact, when the assessments are presumed valid, case law teaches that it is not up to Revenu Québec to prove when and how the shareholder received the funds.

For example, in *Bastrach c. Agence du revenu du Québec* 2020 QCCQ 953, the auditor had reconstructed a bar's ratio of cash sales per ounce of alcohol sold. Assessments had been issued personally to the shareholders as appropriation of funds in proportion to their holdings in the corporation.

Ultimately, the personal assessments were confirmed by the court. The judge criticized some of the plaintiffs for the lack of evidence as to their finances and standard of living and with respect to the corporation's use of the undeclared cash inflows.

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