

The Audit

The Audit

**How an Honest Mistake
Became a Federal Crime**

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Strategic Book Publishing and Rights Co.

Introduction

The Audit is based on the actual circumstances of a small business accountant during a routine audit that resulted in a criminal investigation and charges being laid.

This book is dedicated to the three stooges at the Saskatoon Tax Services office, and all the beloved stooges taking up space at Canada Revenue Agency (CRA) offices across this country and the Internal Revenue Services (IRS) offices in our sister country, the United States.

These three are fondly known as Larry the Auditor, Curly the Investigator, and Moe the Enforcer. They are very proud of their abilities—and rightfully so! After all, they usually possess at least a Bachelor of Commerce degree, which certainly is more education than your average high school graduate. Our tax lawyers and court prosecutors can boast this same distinction. In addition, there was no time wasted on practicing newfound skills or gaining any business-like experience. They only had time for theory—how practical!

For those of you who are indeed more educated, experienced, professional, logical, and aware of the hardships of small business, please do not feel included in this interpretation of what the CRA calls “service.” There are those, too, who are in different departments and are noticeably polite and helpful. In fact, you are probably performing your required tasks right now without appreciation. Performance, not quotas or power, continue to be your priority, and for that we thank you.

Unfortunately, the stooges are under the impression that they attended the James Bond Spy School. They believe that their actual specialty is successful implementation of smoke-and-mirror tactics. They are so proud! In their worldly experience, the stooges believe that all taxpayers are dishonest, but they will not succeed with evasion on their watch.

A typical day of auditing for them probably includes things like “Darn, can’t really see anything suspect in this file, but if we interpret this question a certain way . . . yup! Got ’em! Now, how big of a deal should we make of this? Criminal perhaps? Oh, wait. Can they afford a lawyer? Gee, that’s too bad. They could have appealed. Next!”

Of course, this is only one of many possible versions of the route taken to lead them to their seemingly predetermined results.

“Crystallization” is a ritual performed by our elite that should render any so-called evidence inadmissible. When the CRA audits a taxpayer and sends it out for investigation without that person’s knowledge, and before the outcome of an audit, it becomes suspect. The courts have held that when an investigation “crystallizes” into a criminal investigation, the taxpayer becomes entitled to constitutional protection against self-incrimination. However, the CRA and the court officers in this case chose to ignore this huge auditor no-no, and denied the taxpayer one right: fairness (see the CRA’s mission statement that follows). The taxpayer’s history of compliance, credibility, and cooperation was not even considered.

The audit and resulting investigation has been ongoing for nine years now. Sharing the responsibility of slow progress is the taxpayer, who became chronically ill and was unavailable for six months. However, the continued assaults by the CRA were business as usual: a search at Land Titles for my husband’s

THE AUDIT

property to which they had no right, cancelling my e-file status, crippling income-earning opportunities, and the list goes on.

I am the said taxpayer: TIPO (Taxpayer is Pissed Off!). Although the bird's-eye view of this, yet another stellar performance by the CRA, is quite amusing, the fact still remains that any form of unbridled power is frightening. The ease in which lives can be ruined is beyond any logic and common sense. The punitive financial remedies demanded by the CRA are, in most cases, excessive, suffocating, and just not necessary.

We are not alone, however. Our American neighbors, who have similar taxpayer rights and protections in place, are also subject to the same tactics and bullying by the IRS. Unfortunately, their stories and the outcomes are all the same.

Who is watching the watchdogs?

I hope you enjoy this book and either learn from it or totally relate to it.

CRA Mission Statement (as per CRA website)

CRA Mission – What we do:

To administer tax, benefits, and related programs, and to ensure compliance on behalf of governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians.

CRA Vision – Our Future:

The CRA is the model for trusted tax and benefit administration, providing unparalleled service and value to its clients, and offering its employees outstanding career opportunities.

CRA Promise – Our Commitment:

Contributing to the well-being of Canadians and the efficiency of government by delivering world-class tax and benefit administration that is responsive, effective, and trusted.

CRA Values – Our Guiding Principles:

Integrity is the foundation of our administration. It means treating people fairly and applying the law fairly.

Professionalism is the key to success in achieving our mission. It means being committed to the highest standards of achievement.

Respect is the basis for our dealings with employees, colleagues, and clients. It means being sensitive and responsive to the rights of individuals.

Co-operation is the foundation for meeting the challenges of the future. It means building partnerships and working together toward common goals.

Author's note

As portrayed to the public, the CRA mission is to administer taxes, benefits, and related programs, and to ensure compliance on behalf of the governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians. The CRA also boasts that they are the model for trusted tax and benefit administration, providing unparalleled service and value to its clients, and offering its employees outstanding career opportunities.

Their commitment, as posted in their publications, is to contribute to the well-being of Canadians and the efficiency of government by delivering world-class tax and benefit administration that is responsive, effective and trusted.

If the CRA's mission statement was actually achieved—which would require the absence of egos and the appetite for power, money, and recognition—it should be applauded. Realistically, though, the mission statement resembles the result of, perhaps, a high school social studies class project that requires students to “Describe the perfect administration for the finances of a country.” The requirements of the project obviously did not specify which planet this theory might be successful on.

Disclaimer

All stories in this book are based on true and actual events as witnessed by the writer. These events cannot be considered evidentiary, since all names have been changed, and will not be substantiated by persons (or incidents) that are referred to during the course of reporting events that occurred and the resulting outcomes of each featured story.

By the close of this book, the reader will most likely acknowledge the need for protection against reprisal offered only by way of anonymity.

TIPO

Table of Contents

Chapter 1	What is an Audit?	1
Chapter 2	A Posted Publication on the Internet	3
Chapter 3	The Audit and Findings	5
Chapter 4	Other Audit Findings	7
Chapter 5	What is an Amended Return?	10
Chapter 6	Search and Seizure	14
Chapter 7	Another Search	19
Chapter 8	Attorney Rose and the Plea	21
Chapter 9	Should Have Known Better	25
Chapter 10	Anonymous Quote	28
Chapter 11	DWDs and the Trick Question	29
Chapter 12	Splitting Hairs	40
Chapter 13	Lost Records	42
Chapter 14	Can You Believe This?	46
Chapter 15	Case Management	50
Chapter 16	What is an Ombudsman?	53
Chapter 17	To be Fair	56
Chapter 18	Auditor Accountability	57
Chapter 19	Auditor Development and Employment	58

FRANCINE MESSIER

Chapter 20	Salary Statistics	61
Chapter 21	Independent Investigations	65
Chapter 22	The Attempted Trial and Rescue	67
Chapter 23	The Trial	92
Chapter 24	The Verdict	128
Chapter 25	Taxpayer Bill of Rights	136
Chapter 26	Concluding Thoughts	138

Chapter 1

What is an Audit?

From Wikipedia: “Auditing is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of any enterprise for a stated purpose.”

Within the CRA, there are many different divisions, one of which is the Audit Division. Auditing is a necessary function in any enterprise (including the financial operations of a country), to ensure that the structure and framework of operations is running efficiently enough to maximize performance and profitability. It is necessary for the CRA to recognize any problems caused by a taxpayer or company’s deception or failure to report information for their own gain. This affects all taxpayers, who wish only to contribute what is required of them, and not a penny more. We all know of those who habitually ignore the guidelines for honest and cooperative reporting. Thus, auditing is a necessary evil from time to time. However, it should not be considered as divine power by the auditors.

The CRA will also commendably add that the purpose of an audit is also to bring certain errors or miscalculations to the attention of taxpayers that may be corrected by way of amended returns. The primary motivation, according to the CRA mission statement, is to keep the taxpayer well informed of his or her

obligations—gentle guidance, so to speak, provided in a spirit of teamwork, to be sure we are all on the same page.

Maybe on the planet Happy!

Some of our new graduates from “spy school” seem to have expanded and honed the definition of audit to “catch the bad guy!” And since it is their belief that all taxpayers are dishonest, they are faced with the abominable task of catching us all. Poor souls, the strain of this momentous burden must be overwhelming. Their patriotism should be applauded! You can read more about such tactics in the next chapter.

Chapter 2

A Posted Publication on the Internet

Imagine that you run a successful business and report a net income of tens of thousands on revenues of several hundred thousand dollars a year. You hire a respected accounting firm to prepare your financial statements and tax returns each year. All appears to be going well.

Now imagine that a CRA investigator shows up on your doorstep intimating that you are under investigation for tax evasion. He suggests that you have intentionally underreported your business income by \$1.7 million over a three-year period. He also says that you can reduce the civil reassessment of tax to *less than \$100,000 if you just plead guilty to tax evasion charges*. You refuse, maintaining that you have done nothing wrong. The CRA later reviews the civil reassessment proposal, noting several manifest errors, but issues the reassessments as proposed, errors and all, forcing you to contest them in the Tax Court of Canada.

Sound farfetched? Those are the facts alleged in “Taxpayer” v. The Queen, a case decided by the Federal Court of Appeal (FCA). The taxpayer was reassessed and pleaded the facts above and more. The Crown sought to strike virtually all his pleadings on the basis that the Tax Court’s jurisdiction is limited to merely reviewing the correctness of a valid assessment, not the process by which the assessment arose. The FCA agreed with the lower

FRANCINE MESSIER

court in striking a portion of the taxpayer's pleadings. In doing so, it held *that a civil servant, such as a CRA auditor, may act completely outside the scope of his authority*, but the reassessment resulting from his actions is still subject to the same appeal process in the Tax Court as any other validly raised assessment. *It matters not that the process by which the assessments were raised may have been corrupt.*

Chapter 3

The Audit and Findings

On March 12, 2008, Larry the Auditor arrived at my office for our scheduled interview regarding an audit of me and my corporation. He seemed cordial enough. What I eventually discovered, however, is that he was an “end justifies the means” kind of guy.

He dug deep for any information on previous dealings that I may have had with the CRA—up to twenty years prior, I might add. For all of the years that I have reported to the CRA, there were many instances in which a confrontation ensued. These are inevitable when your clients need protection from assaults that may be directed at them, at any given time, by the CRA.

On the same visit in March, he also collected all of the records for a corporation of which I was a partner, along with my husband and one other couple. My husband and his partner actively operated the business, while I prepared the financial documentation. This was a large corporation that involved reams of paper and thousands of transactions. The file was clean. It must have been a sad, sad day at the ivory towers when the CRA issued a “no findings” result. Larry the Auditor returned the records, and, as if prompted by a teacher in etiquette class, mumbled something almost resembling appreciation for my work.

However, his energy was renewed when he was now able to, hand on hip, inquire as to the reason that my personal business records were not quite so pristine. It would seem that, since he was barely old enough to shave, he had yet to hear the old “shoemaker’s son has no shoes” theory. He was confused as to why client files received more attention. Sighing, I had to state the obvious: “Because clients pay.”

Later on, the shoemaker analogy would ring true. I had made an error. But do not panic; it was of little consequence. The CRA, however, would try to prove *mens rea*, which translates into criminal intent.

Approximately two years prior, an idea had formed for a web-based business. I was thinking at the time of providing residual income for retirement. In order to launch this idea, funds would have to be obtained from the sale of my existing company. The resulting funds were deposited into my corporate account, and I carried on in my merry way. However, in my haste to move forward, the sale was recorded incorrectly on my tax return. This small, transparent oversight soon became a major problem.

There was joy in the ivory towers that day, as Larry the Auditor had found a bone! He would gnaw on that bone until he disappeared behind the wall of paper he had created. Somewhere in this wall lay one little tax return in need of repair.

Disgusted with my oversight, I began to prepare an amended return.

Chapter 4

Other Audit Findings

During the course of the audit, Larry the Auditor noticed that I cashed checks for my children from time to time. They were just beginning their adult lives and had yet to be granted cash privileges on their bank accounts. Once deposited, their checks would be held for five days, and of course, rent was due, car payments or utilities, etc. I would deposit their checks into my account and withdraw the same amount for them. Larry the Auditor was happy with the corresponding bank transactions.

However, there were times when the children just needed to borrow a couple of bucks. Larry was shocked that a parent would lend their children money! His children would never get away with that. He was so cute, not even realizing that he was so far off the audit path that I was expecting a parenting skills seminar at any moment. Anyway, these loans to the children would often be repaid by paycheck, GST benefit checks, or income tax refunds. Of course, these deposits were made without corresponding withdrawals. These amounts were payments on loans, not the cashing of checks.

Now, without in-and-out transactions, little Larry is confused. This confusion would manifest itself into suspicion. Why would my children be *giving* me money? Perhaps they were helping to fend off my pending starvation! Since there were no signed loan

agreements with my children, Larry the Auditor deemed those loan repayments to be unreported revenue.

Straining logic, I had apparently charged my children a total of \$16,146.99 over the course of three years to prepare their simple five-minute returns. So, for three children, that totaled nine returns charged at \$1,794.11 per return, which for a five-minute return translates into \$21,529.32 per hour! Was Larry out sick the day they taught thinking? I will be expected to pay tax on these amounts. Now, Larry the Auditor had the audience's attention. He was pumped!

In this same time frame, I received a check from London Life Insurance Company in the amount of \$4,759.50, representing the cash value of my policy that I had cancelled. Even after pointing out that the note on the check attachment read "loans or surrender of policy," these funds were listed in "unreported revenue." I must be so good at my job that the massive insurance company came all the way to Saskatoon and searched out my little office just to find me to work for them. Absurd! With all of his adrenaline flowing, Larry fails to note that the premiums for this policy were never reported as a business expense. Thus, it was a simple reimbursement.

Larry the Auditor was excited and on a roll! He questioned a parking expense listed on my financial statements. My office at the time was downtown, and parking was scarce. I was lucky to find two available parking stalls right across the street from my office. The wisdom of the powers that be would decide that parking is a personal convenience. Thus, the parking amount of \$4,320 over three years was disallowed. If the landlord of this commercial building had charged me for parking in the office rental amount, this would be accepted as a rental expense. This was not logical, but no matter, more files to screw up, and people were watching!

THE AUDIT

The Workers Compensation Board is a government-run agency that will provide financial remedy to employees who are unable to perform their required tasks at the job in which they are employed, usually resulting from an injury sustained at said job. Each employer is required by law to purchase this compensation for their employees. These premiums are paid by the employer and calculated on gross payroll amounts—a worthwhile contribution. Of course, since this is a payroll expense, the cost is a business deduction. In the case of a director of a company, the coverage is optional. That's okay because WCB coverage for directors is capped, and it would not buy you lunch, let alone cover your increased payroll costs incurred in your absence. Also, this particular premium is prohibitive in the amount, considering the coverage available.

An alternative for an owner is to purchase independent insurance to offset the said increased payroll costs should they be unable to attend to their duties. I did exactly that, preferring to pay for peace of mind rather than worry that expenses may not be covered and I would return to a vacant space. The cost of this over 3 years was \$5,699.13, which was comparable to the WCB premiums, but with much wider coverage. Larry the Auditor's curtain call was to disallow this expense, as it was personal.

Whew! Pretty busy day for little Larry, and he still had to run up to the ivory towers and show his new inventions to the elite. They would be so proud of their little guy!

More days and more bullshit, until the whole issue was so confusing that the only starting place was to just charge me with tax evasion, which they did, and try to prove it later.

Chapter 5

What is an Amended Return?

As in every aspect of life, things may be forgotten or misplaced, done without your knowledge, or completed in error. This applies to an individual tax return as well. When completed, either by tax preparer or you, it may come to your attention that changes are required to your already filed return. For up to three years after filing a tax return, a taxpayer may correct, add to, or delete any items from the original return. These corrections can be filed by way of amended returns. Adjustments will be made by the CRA and the balances due or owed will be updated.

There are too many items to list as examples of such omissions, but a few are very common: tardy information from banks or investment companies, unclaimed receipts found after filing, and the realization that an allowable deduction was not known by you and therefore omitted. These could include adoption costs, summer camp for children, safety deposit box fees, caregiver amounts, transit costs, unused tuitions, and the list goes on.

One particular result that is commonly not reported is the loss on proprietorships or rental properties. It is sometimes felt that since the year's end resulted in a loss, it need not be reported. Firstly, it must be reported regardless. Secondly, it may be to your advantage if you have earnings elsewhere. Also, these losses can be carried forward to future years.

THE AUDIT

Items that should have been included but were not, for whatever reason, may cause an increase in taxes owed. Fear of reprisal often deters a taxpayer from amending his or her return. The CRA has offered a program by which you can correct your return by “voluntary disclosure.” This relieves the taxpayer of any presumption of guilt. Or, I suppose, it would depend on who is on the bandwagon at the ivory towers that day.

Apparently, that day, or any other day, was not going to be a good one for me for a long while. I was informed by the genius that the offered amended return would not be accepted from me. It seemed that the allotted time expired. A short time later, Larry the Auditor contacted me to request my signature on a particular waiver. He explained that the waiver would extend the “barre de statute” limitation of three years, which was approaching. In simple English, it meant that the CRA could continue to make adjustments, as the file would remain open. If I refused to sign, I didn’t know the consequence, but he made it sound . . . not good. The bright side was that, with the extension, I would now be allowed to file my amended return. I asked about this, and Larry the Auditor said, “Yes, that is correct,” so I signed the form. However, that was not correct. I had been duped! I would find out later that the need for the waiver was because the audit did not produce any findings of fraud and they wanted more time. The CRA now had free reign.

The stage was now set for another performance! Holding on to my amended return (which merely resulted in additional tax of \$1,972.23), I decided not to panic yet. In Larry’s attempt to please the audience, he would include enough dribble to lead anyone to wonder, “What is your point?” He reported that twenty years ago I was the accountant for a taxpayer whose file landed on the audit desk. In Larry the Auditor’s mind, this was relevant.

You will see later that this was one of the comedy portions of the show.

The second act would require a drumroll: “TIPO has been audited before!” No shit, Sherlock! He drones on about his discovery that I had objected to some of the CRA’s proposed adjustments at that time. He then intimated that that was not the usual response from a taxpayer, and that, perhaps, I may have upset the CRA’s motto of “We said it, don’t argue it!” In a tone resembling that of one trying to reason with a spoiled child, Larry the Auditor reported that the CRA did finally concede and reverse some of the proposed adjustments. The crowd roars! The CRA does NOT concede! They merely decided to take into consideration the information provided in the first place. The verdict was in now; I was not their favorite person. I was assuming that I wouldn’t be invited to any of their dinner parties any time soon.

One of the items partially reversed was the expense for a water cooler. The cost of this was \$10.25 per month, plus \$5.00 per jug of water. Summoning all of their genius, the CRA determined that I must have had the pleasure of pouring a glass or two of water for myself. This would be a personal, not company expense. Fear not! There was a solution to this major dilemma: disallow 30 percent of the cooler cost! Really. No one could possibly be so bored as to fabricate this story. When all else fails, the CRA will search for that elusive needle in the haystack. There are even more examples of this in Chapter 12.

To further illustrate my ability to perpetrate hideous crimes, Larry the Auditor would have you believe that when I requested the return of records (or copies of) required to prepare an argument, I cried “records are missing” in order to conceal that there was no argument to be made. There’s more about that in Chapter 13. Larry the Auditor was satisfied that his expert

THE AUDIT

and diligent sleuthing successfully resulted in his goal to paint a picture of a mindless “cry wolf” sort who did not have any credibility. He hopscotched from one allegation to another to arrive at the overview depicting me as a bad rash, which would be included in the report titled “Information to Obtain Search Warrant” presented to a judge, along with CRA’s—and only the CRA’s—interpretation of events.

I feel badly for the judge who is at the mercy of these patriotic saviors presenting their cases. The judge is well aware that he or she is hearing but one version. The content of Larry’s presentation was speculative, but his performance was convincing. A warrant for search and seizure was issued. Another happy, happy day at the ivory towers! I could almost hear the Keystone Kops clucking away as they designed their plan of attack. Curly the Investigator was probably foaming at the mouth in excitement!