

TaxTalk

RECORD KEEPING

As a taxpayer (whether personal or corporate, etc.), you are required under the Income Tax Act [the 'Act'] to maintain and retain records that will enable your tax liability to be verified. To facilitate the administration and enforcement of the Act, Canada Customs and Revenue Agency ("CCRA") is given extensive powers to inspect your books and records and other documents in the course of conducting an audit, and also to issue requests or demands for information.

CCRA'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 implement updated record management practices to ensure the greatest possible control of tax-related information, whether in paper or electronic form.

This TaxTalk will discuss the record keeping requirements of taxpayers.

RECORD KEEPING REQUIREMENTS – INCOME TAX ACT

The definition of "record" is included in subsection 248(1) of the Act. The definition includes an account, an agreement, a book, a chart or table, a diagram, a form, an image, an invoice, a letter, a map, a memorandum, a plan, a return, a statement, a telegram, a voucher, and any other thing containing information, whether in writing or in any other form.

The definition is very broad. However, for tax purposes, the scope of record keeping required may be reduced. Section 231 of the Act implies that a taxpayer is not required to keep all records, but rather only such records as will enable the taxpayer's own income tax liability to be determined. This interpretation seems to be supported by CCRA itself in its Information Circular 78-10R3. CCRA does not specify records that taxpayers must keep but merely outlines the verification results that must be possible on the basis of the particular books of account and records that the taxpayer does maintain.

Thus, taxpayers appear to still be at liberty to determine on their own what books and records they require, but those books and records that are created, maintained, and retained must contain enough information in sufficient detail to permit the tax determination standard to be met.

Electronic Records

Where records are kept **electronically**, it is not sufficient to retain only a paper copy of the records. The taxpayer must also ensure that the records are maintained in an electronically readable format (with an appropriate program version to read the records) and provide an appropriate audit trail. Responsibility rests with the taxpayer for their electronic records even if a third party, such as a payroll service, is contracted to prepare them. A person who uses packaged or turnkey software to maintain their records electronically is still responsible if the software is deficient in some way, i.e. taxpayers cannot "offload" their responsibilities to software producers.

Reasons to Keep Records

As indicated, there is a statutory requirement to keep records. In one of its guides¹, CCRA outlines reasons why keeping records can benefit taxpayers, some of which are:

1. **Good records can help you identify the sources of your income**

You may receive cash or property from many different sources. If you do not have records showing your income sources, you may not be able to prove that some sources are non-business or non-taxable.

2. **Well-kept records can mean tax savings**

Good records serve as a reminder of deductible

¹ RC4070(E) – Guide to Canadian Small Business

expenses and GST² input tax credits. If you do not record your transactions, you may forget some of your expenses or input tax credits when you prepare your income tax or GST returns.

3. **Well-kept records can prevent most of the problems you might encounter if CCRA audits your income tax or GST returns**

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. This will cost you time. If your records do not support your claims, they could be disallowed.

What Accounting Records Should You Keep?

You need to keep orderly records of all income you receive. Also, you need to keep all receipts, invoices, vouchers, and cancelled cheques indicating outlays of money. Such outlays include:

- salaries and wages paid to others;
- operating expenses such as rent and advertising, as well as capital expenditures; and
- miscellaneous items, such as charitable donations.

If you import goods into Canada, your records must substantiate the price you paid for 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.

All records, including those stored in an electronic medium (e.g., on computer disk), must be kept in Canada or made available in Canada at CCRA's request. You can keep these documents outside Canada, but only with written permission from CCRA. You have to make these records available to CCRA if you are asked to do so.

Whichever accounting or record keeping method you use, your records must be permanent. They must contain a systematic account of your income, deductions, credits, and other information you need to report on your income tax and GST returns.

It is not difficult to keep records that meet the requirements of the law. However, sketchy or incomplete records that use approximate, instead of exact amounts, are not acceptable.

Your books and records must:

- allow you to determine how much tax you owe, or the tax, duties, or other amounts to be collected, withheld, or deducted, or any refund or rebate you may claim; and
- be supported by vouchers or other necessary source documents. If you do not keep your receipts or other vouchers to support your expenses or claims, and there is no other evidence available, CCRA may reduce or eliminate the expenses or claims you have made, i.e. the onus is on you to substantiate your expense claims if questioned.

Retaining and Destroying Accounting Records³

You must retain books and records (other than certain documents for which there are special rules) for six years:

- after the goods are imported or exported,
- from the end of the last taxation year to which they relate for income tax, or
- from the end of the year to which they relate for GST purposes.

If you filed your income tax return late, you must keep your records and supporting documents for six years 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. For example, let's say you bought some restaurant equipment in 2000 and sold it in 2002. In this case, even though the records relating to the purchase of the equipment were created in 2000, you need them to calculate the gain or loss on the sale in 2002. Therefore, you must keep the records until 2008.

You have to keep every book and supporting record necessary for dealing with an objection or appeal until it is resolved and the time for filing any further appeal has expired, or until the six year period mentioned above has expired, whichever is later.

Request For Early Destruction

If you want to destroy your books or records before the six

² GST – Goods & Services Tax

³ For more information on keeping books and records for income tax purposes, refer to Information Circular 78-10, *Books and Records Retention/Destruction*

years are 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 CCRA, there are other federal, provincial, and municipal laws that require you to keep books and records. CCRA has no authority to approve destruction of books and records that these other laws require you to keep.

RECORD KEEPING REQUIREMENTS – OTHER JURISDICTIONS

The above discussion has summarized record-keeping requirements as per the Income Tax Act. There are other legislative requirements to keep records, with **timelines that could differ from those outlined above.**

For instance, Ontario's Tax Information Bulletin – 'Retention/Destruction of Books and Records - states the following with respect to the destruction of records:

"In general, the books and records to be destroyed must relate to the business' fiscal year that ended more than seven (7) years before the beginning of the fiscal year in which you plan to destroy the books and records."

Other government agencies, e.g. Workplace Safety & Insurance Board, Employment Insurance etc., will have their own rules, which again could differ.

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

PERMANENT RECORDS

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

- 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 (OBCA) 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 1 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 in this regard include the following:

- Are there sufficient controls 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?

- Are your records physically secure?

Do you have preventative measures in place such as a fire proof safe, locked premises, and /or a method 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?

- 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?

- 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?

To conclude, good record keeping is a critical success factor for any business or taxpayer. The discussion above provides an overview of records that need to be kept in order to satisfy CCRA and to substantiate that your income and expenses are fairly recorded.

APPENDIX 1

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.

A memorandum of this nature cannot be all encompassing and is not intended to replace professional advice. Its purpose is to highlight tax-planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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