Working through an audit

So the CRA wants to audit your books. Now what do you do? Rintoul says that audits usually result in no charges, no jail, and in most cases they are not adversarial. So don't panic.

When facing an audit, Rintoul advises retailers to remain calm and call an accountant. "Let the accountant handle the audit because the accountant speaks the same language as the auditor," says Rintoul.

MacInnis agrees. "Good tax planning and risk management does not take place in a vacuum. You get into most tax issues when you try to do it yourself. These are often errors of omission, not commission."

If the retailer can't afford an accountant, there are two strategies for handling the audit on their own: 1) identify risk areas (areas where they may have been aggressive with claims or deductions) and raise them to the auditor; or 2) choose to stay circumspect and raise them when the auditor brings them up.

"Remain friendly and honest," says Rintoul. "They're doing their job. If you're friendly and calm and honest, the dealings tend to be easy."

Remember that you don't have to answer the auditor's questions right away. It is acceptable to ask the auditors to provide their questions in writing and to ask for time to provide an answer.

Thulien's common audit issues

According to Thulien, issues that arise during an audit of a retailer's books often involve sales taxes and questionable deductions.

Restrictions on what you can claim as an input credit for meals and entertainment.

"Only 50 per cent of meal and entertainment costs are eligible for an input credit, in the same way only 50 per cent is deductible for income tax."

Taxable benefits to employees.

"When the employer provides taxable benefits to employees, those are generally subject to GST. GST gets included in the amount of the benefit. By the same token, the employer has to include that GST in what they remit to the government. That remittance part of it gets missed sometimes."

Self-assessment of PST, when a retailer in a PST province purchases product from a non-PST province.

"Sellers outside the PST province don't charge PST. When you bring the product into the PST province, you're supposed to self-assess the PST. That self-assessment commonly gets missed."

Selling to other businesses.

"If you sell to a business and they're claiming exemption from PST because what they're buying is for resale, make sure you get an exemption certificate so you're not on the hook for PST you didn't collect."

Self-assessing PST on promotional items.

"If I'm a retailer buying products, normally I'm exempt from PST because I'm purchasing those items for resale. When I sell to the individual, I charge PST at check-out. If I'm giving something away, then I'm not charging PST, I'm not collecting PST, but I still have to cover the PST based on the value out of my own pocket. Companies forget to self-assess PST on give-away items."

A GOOD TIP: Look for tax incentives hidden inside government budgets. If you don't have time to ferret out these incentives, subscribe to news feeds from Retail Council of Canada or one of the major accounting firms who alert retailers to changes in tax law.

A GOOD TIP: With corporate tax rates shrinking, look for ways to move claims into the future, when incentives are higher.

A GOOD TIP: Brush up on what goods are tax exempt in your province and update your POS software and your staff training accordingly.

For more Retailer's Guides, including topics concerning store operations, loss prevention, human resources and other areas of interest, visit **www.retailcouncil.org/training/retailersguides/**

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retailer's guide

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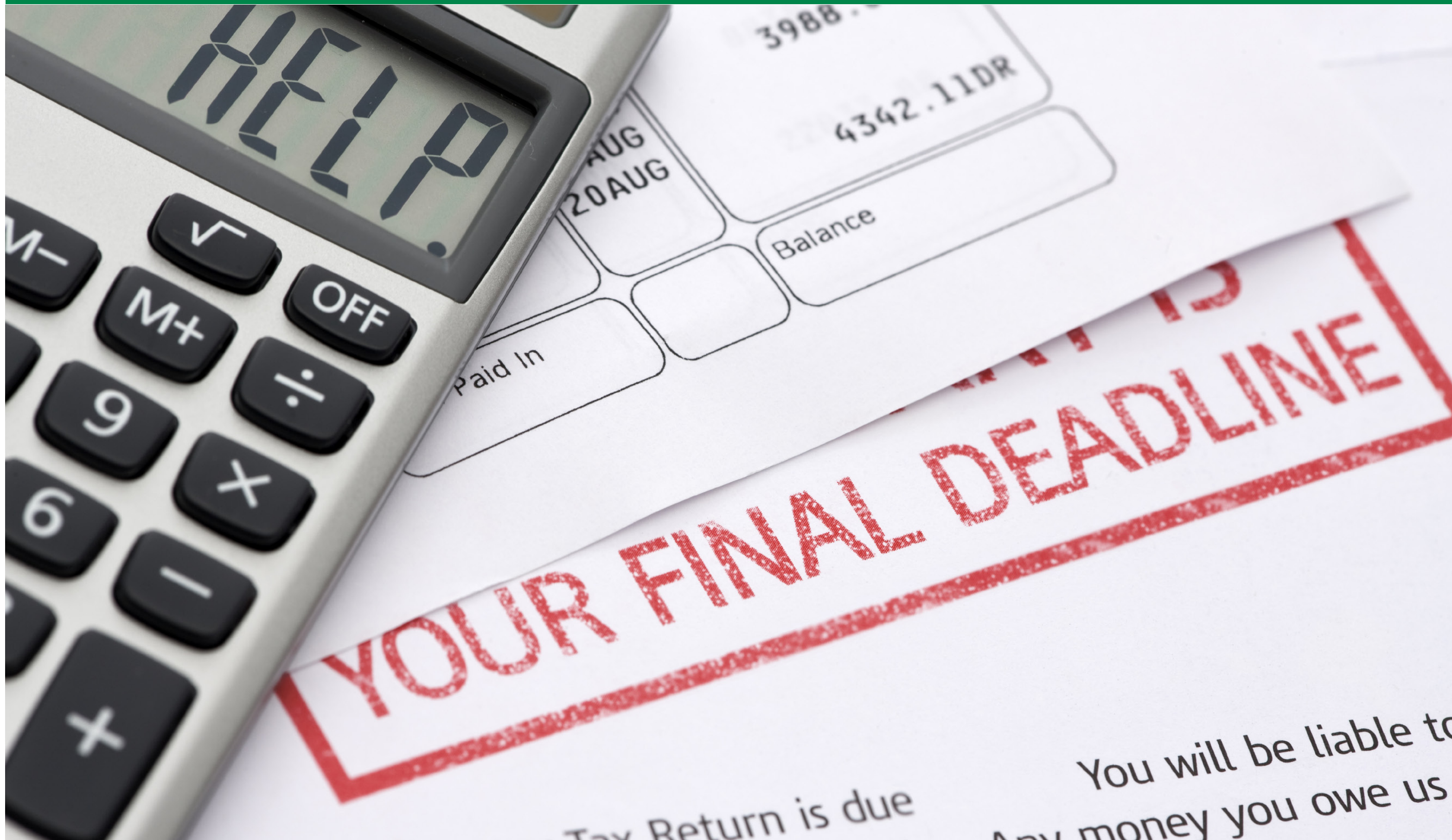

HOW NOT TO DREAD ACCOUNTING

BY ROBERT PRICE

When it comes to taxes and accounting, most people respond in one of two ways. The first way, procrastinate. The second way, hire an accountant and ignore it.

Neither of these responses makes sense for the business, and even retailers on the up-and-up can find themselves dreading accounting. As Mark Rintoul, a tax expert at Buchanan Barry LLP explains, "Income tax and sales tax rules are horrendously complex and it's easy to have blind spots."

This *Retailer's Guide* offers tips to help make accounting less dreadful and to remove some of those blind spots. Take it as a reminder of things you knew and forgot, and things you didn't know you needed to know.

TIP #1

Make accounting easier for yourself

The more accounting that retailers can do for themselves, the less they have to spend on accountants. To make this happen, many retailers will benefit from rethinking how they manage their affairs.

Rintoul says an efficient account style is "not complex but organized, a system you can dip into and out of as the year goes by." What does this look like? All bank statements are reconciled and put in a binder. Paperwork from suppliers, customers and employees are separated into different sections. An accounting software program ties it all together and helps squeeze tactical business insight from the data. It's neat, tidy, and built so that the manager can add to it a week at a time.

"The better your system for accounting—it should give you a complete picture of the finances—the easier working with the system becomes and the better the quality of information it spits out," says Rintoul.

TIP #2

Develop a compliance calendar

One way to remember tax-related deadlines is to create a compliance calendar. A compliance calendar includes all the important tax deadlines, including due dates for T-4s, payroll, year-end filing, quarterly filings, and payment dates. A helpful compliance calendar will also include time for retailers to do the bookkeeping because attacking the accounting throughout the year makes the end-of-year easier. And remember to make time for whatever correspondence you may need to do with other people to meet these deadlines.

TIP #3

Be specific about bad debt

Retailers who claim bad debts under a general reserve may want to consider being more specific about how they identify and claim bad debts.

"A general reserve is viewed as a contingent reserve for tax purposes, and contingent reserves are not deductible for tax purposes," says Matthew MacInnis, Partner, Tax Services at Ernst & Young. "But there is a provision in the income Tax Act to say that if you're able to specifically identify bad debts, then they will give you a reserve for it. Simply by taking the time to identify bad debts rather than taking a blanket general reserve against bad debts can give you a tax deduction that you wouldn't otherwise have available to you."

For retailers, this can be significant, since inventory that will never sell can be classified as a bad debt. "If you're able to specifically identify what inventory has evaluation problems, then you are able to take the lower of cost and fair market value as your carrying amount for inventory."

TIP #4

Pay your taxes on time

File this tip under "no kidding," but as Rintoul explains, "A lot of clients won't file tax or GST because they don't have the cash flow. Penalties for filing late are an unnecessary cost." Interest charged by the government on late payments is not deductible.

TIP #5

Make your accounting work for the business

Rintoul says that having a good handle on the books is good for the business—not only because it makes tax season easier but because it can help operations run more profitably.

He suggests retailers structure their books in a way that gives them a view into the way money moves through the business. When are cash flows high? When are sales down? When have loans been necessary? When do expenditures peak? When retailers have this information, they can look for cost-savings and track purchasing to maximize volume discounts. Consider going a step further and tying financial data into store-related data, like traffic counts and basket size. A complete picture of the store's financials will help retailers in knowing what sales strategies work and which trends they should follow.
Another benefit of making the books a cornerstone of running the store: retailers can restructure business affairs, like the year-end, to align with cash flow and customer traffic. Be busy with taxes when you're not busy with customers.

TIP #6

Know the tax rate

"Know the tax rate you're charging," says Shawn Garrett, Manager, Indirect Tax Recovery and Risk Services at Ernst & Young.

Currently, there are four effective GST tax rates across Canada. Garrett explains that retailers shipping to other provinces have to remember to charge the GST rate of the province receiving the shipment, not the province of the sender. The problem with charging the wrong tax rate is that if a retailer is reassessed, they'll owe the difference, and in retail you can't go back to the customer to charge the missed taxes.

"Just by failing to charge the right tax rate could result in a large audit assessment," says Garrett.

TIP #7

Track returns and coupon redemptions year-over-year

Here's a situation. A store promotes a new product with a coupon campaign. In total, the store releases $5,000 worth of coupons to the public. Can the store claim the full value of those coupons as a deduction? No, they can't, but they can deduct a portion if they can prove the store's historic redemption rate on coupons.

"Tax authorities commonly do allow a deduction if you can show clear past experience," says Ryan Thulien, a Tax Partner at PriceWaterhouseCoopers. "If you can support through history you might be able to claim a deduction for those kinds of accruals."

The same goes for returns. Every retailer will have a certain portion of their sales come back as returns, and returns can only be deducted when the return actually arises. But, if the retailer can prove the store has a history of customer returns of a particular percentage—if they are able to provide evidence that X per cent of products are usually returned each year—they may be able to claim these returns as a deduction.

TIP #8

Deduct integrated POS equipment

Retailers should investigate claiming deductions on POS equipment, like scanners, that integrate directly into the store's computer and inventory tracking systems. "We've seen interpretations from the CRA that accept that scanners and equipment that integrate into the computer system can be treated as computer equipment, which have a much faster tax write-off than general equipment," says Thulien

TIP #9

Know how many gift cards come back to the store

Retailers who sell gift cards may be able to make room for deductions if they can show how many gift cards are redeemed.

Here's how it works: When a retailer sells a gift card and receives cash, the tax rules say that cash is income. But, and this is important, the retailer is allowed to claim an offsetting deduction for goods they're going to have to reasonably deliver at the end of the year.

The question then becomes, how much of these gift cards will actually be used? What's the right number to claim? The CRA will say a reasonable reserve is based on what the retailer expects to be redeemed or used.

"That gets to be a hard thing," says Thulien. "It can come down to being a bit of an arbitrary negotiation with the tax authority about what a reasonable number is. Some reserve against that gift card income should be allowed so that your income for tax gets recognized when the card gets used, not when you sell the card." The same logic applies with gift certificates.

TIP #10

Structure leasehold improvements in a way that maximize deductions

Leasehold improvements—the money a store invests in improving the appearance of the store—can be deducted. This is good news. But there is a catch: the period within which these deductions are claimed can't be less than five years. Knowing this, when negotiating leases, retailers may want to consider structuring the lease on five year terms to allow them to maximize their leasehold improvement deduction.

Retailers might have business reasons to sign a lease for a long-term, but if it's possible, shorter term leases with more renewal periods will allow retailers to deduct leasehold improvements faster—over five years, rather than spreading those deductions over 10 or 20 years. As long as retailers hold the option to extend the lease, a four year plus one year renewal might be a better way of structuring a lease.