CRA Audit: Top 3 Red Flags That Could Get You in Trouble

Description

Filing your tax returns with the Canada Revenue Agency (CRA) is a painstaking annual process. Unfortunately, some taxpayers have to go through the added pain of being audited. Thousands of CRA audits are launched every year and your chances of being picked up for one could be higher if you earn or spend your income a certain way.

With that in mind, here are the top three red flags that could make you prone to a CRA audit — and what you can do to mitigate the risk.

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Being self-employed or in business

A jaw-dropping 54% of the CRA's audit budget is spent on auditing small and medium-sized businesses every year. This is by far the largest category of tax filers targeted by the agency — and with good reason. Self-employed taxpayers and business owners have complicated tax filings and plenty of opportunity to manipulate expenses or income. In a given year, the CRA audits on businesses of this size uncover $1 billion in additional tax payments. So if you're part of this cohort, your chances of being audited are relatively high.

Living large

Living far beyond your means is another red flag. The agency can match declared income to the level of spending or the value of your home to find discrepancies. Any discrepancy could trigger a CRA audit. However the agency is likely to reach out and ask for clarifications first.

Previous CRA audits

An audit is much more likely if you’ve been audited in the past. Avoiding an audit is beyond your control. However, you could mitigate the impact by diversifying your sources of income and simplifying your tax situation.

Protect yourself

The obvious way to protect yourself is to file your taxes diligently and manage documents well. However, another way to mitigate the tax burden is to maximize your income from tax-free sources.

Tracking and declaring dividend income or capital gains is relatively transparent. In fact, your stock broker will offer an annual form with all your trades and tax liabilities. Which is why maximizing investments through your Tax-Free Savings Account (TFSA) could simplify your tax situation.

My top pick is **BCE Inc.** (TSXBCE)(NYSE:BCE) a robust, high-yield dividend stock. BCE offers a whopping 6% dividend yield. If you maxed out your TFSA ($75,500) on this stock, you could expect $4,700 a year in income. That’s nearly two-months of the median salary!

Over time, if you keep maximizing your TFSA room and deriving high dividends, you could fund most of your expenses from investments alone. At tax time, your filing would be clear and simple. This would reduce the anxiety of every facing a CRA audit.

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Bottom line

CRA audits are fairly common. In fact, the agency uncovers billions in unpaid taxes every year. If you spend beyond your means, own a business or have been audited before, your chances are higher than average.

Earning more income from dividend stocks and capital gains is the best way to maximize passive income and simplify your tax situation.

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