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Doing it right the first time! Avoiding the most common tax return errors

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Preparing your tax return can be a daunting task. While reports have indicated that nearly 70%[1] of individuals engage tax preparers to help them wade through the complexities of preparing a tax return, the Canada Revenue Agency (CRA) has identified a number of common errors in personal tax returns. For example, statistics show that in recent years the CRA disallowed almost one of every five claims that were made for key tax credits and deductions[2] and assessed over $1 billion in additional tax,[3] primarily by comparing information on taxpayer returns to information provided by employers, financial institutions and other sources.

Making an error on your tax return can be costly for you as a taxpayer because if, for example, income is not reported or if deductions are claimed erroneously, the CRA will charge interest on any overdue tax amounts that you may owe.[4] And if you fail to file your tax returns on time or underreport your income, you can incur significant penalties as well.

In this report, we will review some of the most common adjustments identified by the CRA with a view to helping you prevent issues before you file your own tax return this filing season.

[1] Proposal — *Registration of Tax Preparers Program Consultation* published by the CRA, which is available online at http://www.cra-arc.gc.ca/gncy/cmplnc/rtpp-pipdr/cnslttnppr-eng.html.

[2] Ibid.

[3] Ibid.

[4] The interest rate charged on overdue taxes for the first quarter of 2019 is six percent. Quarterly prescribed interest rates are published on the CRA website at http://www.cra-arc.gc.ca/interestrates/.

1. Reporting Information from Tax Slips

Figure 1 shows some common income tax slips that are issued in Canada for investment income, along with the deadline for distributing these slips for the 2018 tax year.

Figure 1: Common Income Tax Slips Issued to Investors

Tax slip	Type of income	Deadline for distributing slips for the year ended December 31, 2018
T3 – Statement of Trust Income Allocations and Designations	Trust income, including allocations of interest, dividends and capital gains	April 1, 2019[5]
T4RIF – Statement of Income from a Registered Retirement Income Fund	Income from a Registered Retirement Income Fund (RRIF), including withdrawals	February 28, 2019
T4RSP – Statement of RRSP Income	Income from a Registered Retirement Savings Plan (RRSP), including withdrawals	February 28, 2019
T5 – Statement of Investment Income	Distributions of certain investment income, including interest, dividends and capital gains	February 28, 2019
T5008 – Statement of Securities Transactions[6]	Dispositions of securities during the year	February 28, 2019
T5013 – Statement of Partnership Income	Partnership income, including allocations of interest, dividends and capital gains	April 1, 2019[7]

Be sure that you give your current mailing address to all financial institutions at which you have financial accounts so they can send you all of your tax slips. You may want to compare the tax slips that you receive for the current year to slips you've received in the past, to see if any might be missing. You may also want to compare income reported on investment statements to the amounts from tax slips, to see if there could be differences that could be due to slips that have not been received. If you haven't received an expected slip shortly after the deadline shown in Figure 1, you should contact the issuer to request a duplicate.

If you are still missing a tax slip despite your best efforts to obtain it, you may be tempted to either submit your tax return without the missing information and adjust it later, or to wait until you receive the slip to file your return. Both of these approaches may be problematic.

If you file your income tax return on time but fail to report income for the current year and one of the previous three taxation years, you may face a penalty equal to 10% of the income that you did not report in the current year. The court case highlighted in Figure 2 shows an example of a taxpayer who suffered this 10% penalty for repeated failure to report income.

If you don't file your tax return on time and you have a balance of taxes owing on the payment deadline (April 30, 2019 for the 2018 tax year), the penalty is 5% of the outstanding balance, plus 1% of your balance owing for each full month your return is late, to a maximum of 12 months.

When you are missing information, you should estimate amounts from other available information. For example, if you haven't received a T3 or T5 slip that reports investment income, information from monthly investment statements may help you to calculate the amount of the income.

[5] The normal due date of March 31st is extended to April 1, 2019 as March 31, 2019 falls on a Sunday.

[6] Many financial institutions issue an account statement reporting gains and/or losses during the year in lieu of issuing a T5008 slip directly to clients. The electronic T5008 is still filed with the CRA.

[7] See note 5

Figure 2: Repeated Failure to Report Income

In a case brought before the Tax Court in 2012, a taxpayer failed to report interest income of $876 in her 2006 income tax return and also failed to report $18,376 on her 2008 return. Since she failed to report income in 2008 as well as one of the three preceding tax years, the taxpayer was hit with a 10% penalty both federally and provincially, amounting to $1,837.60 each.

A "due diligence" defence can be used for either the first or second failure to report income when the taxpayer has either made a "reasonable mistake of fact" or, at the very least, took reasonable precautions to avoid the event leading to the penalty.

The taxpayer in the case conceded that no such defence could be made for the 2008 taxation year, so she focused on the 2006 omission of the $876 of interest income. She testified that this omission "was a reasonable mistake of fact. [It was] overlooked … because she was not in the habit of earning and reporting interest income.… Viewed objectively, the mistake was reasonable as the amount of unreported income in 2006 was less than 1% of the income which [she] reported" that year.

The judge agreed that since the amount of unreported income in 2006 was only 1% of her total income, her failure to report it was indeed innocent; however, the judge was not convinced "that a reasonable person in the same circumstances would have made the same mistake." In the judge's opinion, the taxpayer should have realized that she had not received her T5 slip reporting her interest income and yet she took "no actions" to get a T5. As a result, the judge felt that the taxpayer failed to take "reasonable measures to report all of her income in 2006 or 2008" and the penalty was upheld.

Some entities, such as income trusts or partnerships, make distributions throughout the year and will determine the actual components of the distribution after year end. Since T3 and T5013 slips for these entities may not be issued until the end of March, publicly-traded trusts and partnerships are required to disclose information concerning distributions and allocations of income and capital within 60 days after the end of the taxation year. This information is collected and reported by CDS Innovations Inc. on their website.[8]

Once you've estimated the amount of income, you should keep records documenting the payor's name and address, the type of income involved and your calculations. For paper returns, you should attach this information to your return and indicate what you are doing to get any missing slips. If you file your tax return electronically, you should keep this information on file in case the CRA requests it.

When you do receive any missing tax slips, if the amounts differ from estimated amounts reported on your submitted tax return, you can file form *T1ADJ – T1 Adjustment Request* with the CRA to report the correct amounts. Alternatively, once you have received your Notice of Assessment, you can alter your return online by visiting the "My Account" section of the CRA website[9] and selecting the "Change my return" option.

[8] The Mutual Fund and Limited Partnership Tax Breakdown Service (https://services.cds.ca/applications/taxforms/taxforms.nsf/Pages/-EN-LimitedPartnershipsandIncomeTrusts?Open) is an automated system that allows issuers (or their duly authorized agents) to post tax breakdowns for distributions made by mutual fund trusts, mutual fund corporations and limited partnerships.
CDS Innovations Inc. hosts this compilation of blank templates and completed forms as mandated by the Canada Revenue Agency (CRA) and as a courtesy to the members of the Investment Industry Association of Canada (IIAC). Issuers of mutual fund trusts (T3/RL16 - includes publicly traded trust units and closed-end funds), limited partnerships (T5013/RL15), and split share corporations (T5/RL3) report unit-holder distribution breakdowns using the posting facility on this site. Unitholder distribution breakdown information accessed from this website is intended to assist investment dealers in meeting filing deadlines when completing tax information slips for their clients so that clients, in turn, can complete their tax returns and meet their own filing deadlines.

[9] My Account for Individuals is available online at http://www.cra-arc.gc.ca/esrvc-srvce/tx/ndvdls/myccnt/menu-eng.html.

2. RRSP Deduction

An RRSP is one of the best ways to save for retirement, providing a tax deduction for the amount you contribute and deferral of tax on income that is earned within the plan.

Your RRSP contribution limit for a year is 18% of your earned income for the prior year to a maximum amount of $26,500 for 2019 ($26,230 for 2018), minus your pension adjustment, plus any unused contribution room from prior years. To claim a deduction for a given tax year, you can make contributions at any time during the year or within 60 days after year end. To the extent that your contributions are less than the limit in a year, you can carry forward your unused RRSP contribution room and make contributions in a future year.

Contributions in excess of the limits (plus a $2,000 overcontribution allowance) may attract a penalty of 1% of the overcontribution per month. It is, therefore, important to check your available RRSP contribution room before putting funds into a plan. The CRA reports RRSP contribution room on your Notice of Assessment and online through the "My Account" service.[10]

If you expect that your marginal tax rate will be higher in a future year and you plan to wait to claim a deduction for your RRSP contribution in the future, don't forget to report the contribution on your current tax return. On your 2018 tax return, you should report all RRSP contributions made from March 2, 2018 to March 1, 2019. This allows the CRA to determine contributions that are available for deduction and to properly calculate your RRSP deduction limit.

If you want to claim a deduction for a contribution that was made prior to the current tax year and the contribution was not reported on a previous tax return, you should separately file *Schedule 7 – RRSP Unused Contributions, Transfers, and HBP or LLP Activities* for the appropriate prior tax. You may then proceed to claim in on 2018 or subsequent year's tax return.

3. Foreign Tax Credit

If you have investment income from outside Canada, such as dividends on shares of foreign corporations, you may have to pay tax in the country where the income arises. Taxes may be withheld when the income is distributed. For example, dividends from publicly-traded U.S. corporations are generally subject to a 15% U.S. withholding tax under the Canada-U.S. Tax Treaty.[11]

One common error in calculating foreign tax credits[12] is using the wrong exchange rates when calculating foreign income and taxes paid. Amounts must be converted from the foreign currency to Canadian dollars using exchange rates relevant to the transaction. For example, if income is earned evenly throughout the year, using the average exchange rate would be acceptable. For capital gains, actual exchange rates at time of purchase and sale of property would be more appropriate than using an average rate during the time the property was held. The Bank of Canada maintains a list of historical exchange rates that may be used for purposes of tax return calculations.[13]

[10] See note 9.

[11] You cannot claim a foreign tax credit or deduction for foreign taxes withheld on income earned in a registered plan, such as an RRSP or TFSA, since income in these plans is not taxable in Canada. There is no U.S. tax withheld on U.S. dividends paid into an RRSP under the Canada-U.S. Tax Treaty.

[12] A deduction for foreign taxes may be available in some cases when a foreign tax credit is not available or is limited.

[13] Bank of Canada exchange rates are available online at http://www.bankofcanada.ca/rates/exchange/.

An example will illustrate how much of an effect exchange rates can have on income that is reported on your tax return. Suppose you purchased a U.S. security for US$10,000 when the exchange rate was US$1.00 = CA$1.00 and sold the security for US$12,000 when the exchange rate was US$1.00 = CA$1.30. The average exchange rate while you held the security was US$1.00 = CA$1.15. If you used the average exchange rate to convert both the proceeds of disposition and adjusted cost base, the capital gain would be $2,300.[14] If, however, you used the actual rates in effect at the time of purchase and sale, there would be a capital gain of $5,600.[15]

4. Other / Additional Deductions

There are two lines on the *T1 – General Individual Income Tax Return* that are seemingly used as a "catch-all" for deductions: *Line 232 – Other Deductions and Line 256* – Additional Deductions. Although these names may sound like they are meant to allow any number of miscellaneous deductions, each has a specific purpose.

Deductions that are allowed on *Line 232* include: overcontributions to an RRSP that were withdrawn, excess Registered Pension Plan transfers that you withdrew from an RRSP or RRIF and depletion allowances from investments in resource properties. A common additional deduction claimed on *Line 256* is for income that is tax-free under an income tax treaty (such as certain pension or social security benefits) that was included in income on your Canadian return.

The CRA has specifically cited the following examples of expenses that are non-deductible but tend to be claimed erroneously as other deductions or additional deductions: support payments, legal expenses to collect or negotiate child or spousal support, legal fees you paid to get a separation or divorce or to establish custody for a child, funeral expenses, wedding expenses, loans to family members and a loss on the sale of a principal residence.

You should make sure that an expense is deductible before making a claim, to prevent potential penalties and interest on your tax return. The CRA offers information on "What You Can Deduct" on their website.[16]

5. CRA Correspondence

It's important to make sure that you have your current address on file with the CRA, especially if you have moved recently, so you can receive CRA correspondence. Students may overlook this critical step when they transition between their regular home and a student residence.

To verify that income, deductions and credits are properly supported, the CRA may send you a letter requesting that you submit supporting documentation for one or more tax return line items. Unlike a paper return, if you file your return electronically, you don't submit your tax information slips, receipts, or other documents that were used to prepare your tax return; however, the CRA may later ask to see them. Since

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[14] Calculated as $12,000 x 1.15 - $10,000 x 1.15.

[15] Calculated as $12,000 x 1.30 - $10,000 x 1.00.

[16] Information on "All deductions, credits, and expenses" is available on the CRA website at https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/deductions-credits-expenses/deductions-credits-expenses.html

87% of taxpayers filed their income tax returns online in 2018, [17] CRA requests for additional information can be quite common.

You have 30 days to respond to a CRA letter requesting additional information and the CRA will frequently grant additional time if you have reasonable grounds for an extension and contact them within the 30-day time period. If you do not ask for an extension or submit the information within the 30 days, the CRA will assess your return based on the information available, possibly including additional income or denying deductions.

If you disagree with the CRA's assessment of your income tax return, you can file a Notice of Objection. You have 90 days from date of the Notice of Assessment to file *Form T400A* – Objection. [18] You can request an extension within one year after the expiration of the time limit to file an objection.

If you disagree with the CRA's response to your objection, you can appeal to the Tax Court of Canada. Procedures are explained in CRA publication P148 – Resolving Your Dispute: Objections and Appeal Rights under the Income Tax Act. [19] You have 90 days from the response to the Notice of Objection to appeal the CRA's decision. You can request an extension within one year after the expiration of the time limit to file an appeal.

The court case highlighted in Figure 3: Timely Filing of Objections and Appeals illustrates the consequences that ensued for one taxpayer who neglected to heed CRA deadlines. Since failing to act in a timely manner can mean the assessment of additional taxes or a loss of the ability to object to or appeal CRA decisions, it's important to make sure you act promptly when dealing with the CRA.

Figure 3: Timely Filing of Objections and Appeals

A 2013 Tax Court case involved a taxpayer who applied for a court order to extend the time to file an objection for a Notice of Reassessment she received on April 7, 2011 for the 2008 tax year.

The taxpayer filed an objection on April 21, 2012 but it was not accepted because it was beyond the 90-day deadline of July 6, 2011 to file an objection. The CRA, however, did advise her that she could apply for an extension of time and that the deadline for doing so was July 6, 2012.

She filed another objection on November 30, 2012 that was also denied since it was beyond the time limit. The CRA informed her at this time that she was "out of time to apply for an extension."

In March 2013, she applied to the Tax Court for an extension of time to file a notice of objection arguing that "she did the best she could to comply with the law."

The judge was sympathetic and acknowledged that the rules surrounding objections are "complex" and that "taxpayers and their advisors sometimes fail to navigate (them) properly." Nevertheless, the judge denied the taxpayer's application, saying, "The legislative requirements are strict and relief cannot be granted on the basis of fairness alone."

[17] https://www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/individual-income-tax-return-statistics-2017-tax-filing-season.html

[18] Form T400A – Objection is available online at http://www.cra-arc.gc.ca/E/pbg/tf/t400a/.

[19] CRA publication P148, Resolving Your Dispute: Objections and Appeal Rights under the Income Tax Act is available online at https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p148.html.

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