



## compass POINTS:

### **Defending Your Assignees Against the Tax Audit – Some Winning Strategies**

*By Diana Matwichuk, CompassGUIDES HelpDesk Coordinator*

You had a feeling as soon as you walked into your office that it was not going to be a stellar day. Your voicemail message lamp was flashing angrily, your email box was overflowing and your fax machine was hemorrhaging. As if that weren't enough, several expatriates were knocking on your office door, brandishing letters headed with the CRA logo.

The assignee tax audit can rear its head at any time during the year, as can a random payroll tax audit. One often prompts the other. Although tax audits cannot be predicted, anticipating them and being prepared to defend against them can help to minimize stress levels, maintain productivity and contain assignment costs.

#### **CRA Steps Up Tax Audit Frequency**

Assignee taxation is a confusing area and there is always CRA suspicion of tax revenue leakage. As a result, the CRA has been increasing its scrutiny of the income tax returns of international assignees. The CRA budget for fiscal 2005-2006 is \$3.2 billion, of which \$1 billion is allocated to tax audit activities.

Tax legislation in North America is becoming increasingly more complex. New tax regimes are springing up around the world each day – at the country, state, province and city levels. With so much more potential for generating tax dollars, it is economic for the CRA to add more tax auditors in order to increase the flow of tax dollars. Tax revenues fund many government projects, and expatriates are an easy target since they usually earn higher incomes.

#### **Effects of the Assignment Tax Audit**

Assignee tax audits are time-consuming and can cause a great deal of stress for assignees if there is no apparent support from the company. Tax auditors are often inexperienced, amplifying issues which do not warrant scrutiny. Without the advice of a seasoned tax professional, assignees are ill-equipped to sift through the audit issues to determine which ones are critical.

#### **Company vs. Assignee Expectations**

Assignees are accustomed to significant assistance from the company when moving abroad, and as such, expect that the company will continue to provide support in the face of a tax audit. It is usually expected that the company will hire experienced advisors, deal with the issues expeditiously and reimburse assignees for any losses that they might incur as a result of the audit.

Some less reputable companies take the approach that assignee tax audits are not their responsibility, and leave the assignee to sink in a sea of frustration and penalty interest.

## **Result**

The result of misaligned expectations is a disgruntled workforce and a complete lack of trust. Assignees are shocked that their tax approach is being challenged in the first place, feeling that it should have been researched in advance by the company and ultimately been made bulletproof. At the same time, companies are often annoyed at having to deal with stressed assignees regarding something they don't consider to be their responsibility.

## **Division of Responsibilities**

Helping defend against a tax audit actually is the employer's responsibility. CRA reviews of assignee income tax returns can lead to business and payroll audits of the company's affairs. Remitting and reporting are often not being done correctly, and this will be covered in an audit. Lack of pre-assignment tax planning is usually the cause of this exposure.

A coordinated tax audit plan eliminates the need for individual assignees to deal with CRA auditors on their own. Assignees should be working productively on the job, not fretting over their tax audit defenses.

## **What are the Hot Audit Areas?**

When developing and documenting assignment tax policy and procedures, it is important to anticipate potential and common audit areas of scrutiny.

The tax auditor may attempt to deny Canadian non-resident status. This is becoming a common CRA approach, as non-residency status deprives the CRA of a source of tax revenue from foreign-earned income. (Refer to article "[Waving Goodbye to the CRA – Becoming Non-Resident is Creating Problems for Canadian Assignees](#)" for more information on this topic).

Other common audit claims include:

- Disallowance of Overseas Employment Tax Credit (OETC)
- Disallowance of foreign tax credits
- Unreported taxable benefits
- Payment of a portion of remuneration offshore
- Improper tax withholding

Many of these points are related and often arise from a lack of pre-assignment tax planning by the company.

## **Defensive Strategies**

The handling of a defensive strategy to the payroll tax audit should be coordinated, confident and communicative. The overriding objective should be the speedy resolution of all issues.

- Decide on the level of support to be provided to assignees – full, partial or none at all.
- Immediately contain the issue by sending a memo to the affected employees directing them to have no contact with the CRA. All communication with the CRA should be through a central source, and all parties should be aware of this.
- Obtain authority from assignees for the tax service provider to represent them

- Appoint an experienced advisor, and seek an early position paper on the key audit issues. The tax advisor should have experience in the handling of audits, preferably for expatriate employees. Some companies may look to their accountant for advice, who often will have little or no experience with assignment tax audits.
- With the tax service provider's help, review policies and procedures which should be changed, in order to avoid similar audit challenges in the future.
- Determine the extent of the issue and the potential tax, penalty and interest cost, and decide if the assignee will be reimbursed for any losses incurred.
- Remain in control of the information flow to the auditor. Ensure that all questions from the auditor be presented in writing and keep a record of all documents provided to the auditor. Carefully consider requests to provide waivers. Respond to all questions briefly, directly and accurately, without volunteering additional information.

Keep in mind that audit challenges are often not well-founded and often audit claims can be successfully refuted. With any tax audit, there are some issues which have a more favorable treatment than others, and some which can be negotiated. An experienced tax service provider will be able to assist you in building a case for negotiation of audit issues.

### **In Summary**

A happier more productive workforce with a healthy retention rate can often result from a well-planned Assignment Tax Program (ATP). Covering all tax-related assignment issues, from assignment letters to T4 reporting, an ATP places the company in a stronger position to withstand a payroll tax audit.

### **Additional information**

If you would like to read more about defending against payroll tax audits, CompassTAX™ can provide you with a more detailed paper on this topic. Contact our Assignment Manager's [HelpDesk](#) to request a copy of our CompassGUIDES™ publication entitled "Defending Against the Tax Audit of Assignees".

At CompassTAX™, we develop cost-effective assignment tax programs for Canadian companies sending employees around the world and bringing international consultant expertise to their Canadian projects. These Assignment Tax Programs provide detailed advanced tax planning, including policies, procedures and employment contracts, which serve to minimize costs and mitigate any risk of litigation.

CompassTAX™ also offers clients with international assignees pre-departure and re-entry tax planning with a view to minimizing tax and providing experienced tax representation with the Canada Revenue Agency (CRA). CompassTAX™ specializes in all areas of cross-border taxation for consultants coming to Canada temporarily, Canadians moving back to Canada, and individuals living outside Canada with Canadian business ties.

*The author wishes to thank Peter J. Simpson, C.A. for his contribution to this article.*



Tel: (403) 531-2200  
Fax: (403) 263-1826



Tel: (403) 531-2200  
Fax: (403) 263-1826

Email: [cindy@compasstax.ca](mailto:cindy@compasstax.ca)  
[nora@compasstax.ca](mailto:nora@compasstax.ca)  
Web: [www.compasstax.ca](http://www.compasstax.ca)  
Suite 600, 1333 8th Street SW  
Calgary, Alberta Canada T2R 1M6

Email: [diana@compassguides.ca](mailto:diana@compassguides.ca)  
Web: [www.compassguides.ca](http://www.compassguides.ca)  
Suite 600, 1333 8th Street SW  
Calgary, Alberta Canada T2R 1M6