

The Tax Audit – T&E accounts

Common pitfalls of travel and entertainment accounts:

One of the least written about issues is the dreaded tax audit although most of us have participated in a few over the years. This article discusses some of the more common issues I have noted that arise under audit in respect of the travel, meals and entertainment (“T&E”) accounts.

I have found that the tax auditors will devote a *significant* amount of time reviewing the T&E accounts of a company. They are the low hanging fruit; easy to audit and generally contain some level of error. In addition they are a “two-for-one” audit finding – disallowed for income tax as well as GST. Any disallowance in T&E accounts impacts GST reporting as the GST on the portion disallowed for income tax purposes cannot be claimed as an input tax credit. If the CRA cannot obtain sufficient documentation to make a determination, they will typically disallow 100% of the expense..

Larger global companies have tended to centralize the expense reports recording by using an internal on-line system. Employees enter their expenses on-line and then send scanned documents as support to a central location for matching, approval and storage. The central location may or may not be located in the same tax jurisdiction and is generally managed by staff with little Canadian tax experience. The quality of information available for tax audits is dependent the company’s policies and procedures established for expense reporting and the parameters the on-line systems contains. As an example, if the systems defaults all of a salespersons expenses to a “selling expense account” (because it is client related travel) in the general ledger, the company may have hidden gems as described below. Another area of concern is the level of detail available on corporate credit card statements (see below).

The tax authorities will accept scanned copies of invoices as support as long as they are legible and contain sufficient detail. It is important to able to identify not only the vendor and dollar amount but also the nature of the items on the invoice so a description of the items purchased, etc must be obvious from the invoice. If the invoice total is split into various general ledger accounts and departments, it is useful to be able to provide the breakdown.



Hidden gems

Many meals/golf expenses end up being recorded in accounts other than meals and entertainment – selling expenses, conferences, sales incentive packages, sponsorship, trade show, in-house meetings, etc. Regardless of what general ledger account T&E is recorded in for management reporting purposes, it is all either 50% or 100% non-deductible for tax and many companies get caught unintentionally.

Golf

Anything occurring on a golf course, including having lunch at a club house is 100% non-deductible and not 50% as most companies believe. Having said that some client have said they have had success obtaining a deduction if they can show specific invoices for just the meals.

But we re-bill the T&E.....

Some companies will re-bill or bill clients back for a portion of T&E expenses as a means to recoup training costs, etc and then expense all of the related T&E items. The re-billed amount must be supportable with documentation (invoices) and be for exactly the amount spent. In other words charging a client a flat fee as a means to recoup a portion or all of these costs is not “specific” for tax purposes and the T&E expenses remain non-deductible.

Employee gifts and incentives

Gifts and other staff incentives expensed must generally be under per year \$500 generally per employee. Individual department heads may not be aware of these rules and expense incentives/gifts directly or via their expense reports¹. Any T&E paid by the company on behalf of employee or to reimburse for a spouse accompaniment and which is not included in employee’s taxable income as a benefit for the year is not deductible by the company. This arises mostly on sales incentive awards that are cruises / trips.

Corporate credit cards

Corporate credit card statements will generally only contain the name of the vendor and the date of charges as the card holder has the detailed invoice. For items such as an airline ticket, this is not an issue as the tax authorities will generally accept that a payment made to Air Canada or West Jet is for travel. It is however more difficult to prove it is only travel when the card statement only has “Miami Hilton June 3, 2010 for \$855.11”. The tax authority cannot determine from this whether there is embedded in the \$855, amounts for meals and entertainment (or potentially golf). Whenever possible,

¹ See <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/gfts/nwplcy2010-eng.html> for further details on employee gifts and incentives



employees should provide a detailed copy of such underlying invoices for scanning and retention. Hotels and conference charges are the most likely issues here.

T&E Audit Checklist

- If you pay your vendors from summary statements rather than invoices be prepared to have some issues. Generally summary statements will not have sufficient details for the CRA.
- Be aware of all the accounts T&E may be recorded in for management reporting purposes. If possible, revise your accounting policies to permit the recording of T&E into only a few accounts.
- If it's worth it to re-bill your clients, ensure it is "specific" and for exact amounts that can be supported by invoices. Flat fee charges are not specific enough for tax purposes.
- Ensure all sales incentive awards are considered a taxable benefit to the employee.
- Be prepared to dig out the detailed invoices for credit card statements.

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- Assessing whether changes to technology are required,
- Assessing the entity's options under IFRS 1 and running scenario analysis for year two onwards,
- Development and delivery of IFRS training,
- Assisting in redefining the scope, time table and resources required for implementation,
- Preparing the implementation plan,
- Assisting in vendor selection for any technology changes required,
- Preparation/documentation of accounting policies, procedures and processes, and
- Implementing the pilot and entity conversion.

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