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-- Feds know who is likely to cheat ... -- Vern Krishna ... -- April is the month when most Canadians will have filed their personal tax returns. Many wonder if their return will be accepted as filed or if the Canada Revenue Agency will call for an explanation of their deductions. What are the odds of you winning the CRA lottery to audit you? ... -- Governments use statistical probability theory to justify profiling in fighting crime, terrorism and tax avoidance. An audit is an investigation and verification of reported events to determine whether there is "under-reporting" of taxes by omitting income or inflating deductions. ... -- Employees have a low-risk profile because the "pay-as-you- earn" withholding tax

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Governments use statistical probability theory to justify profiling in fighting crime, terrorism and tax avoidance. An audit is an investigation and verification of reported events to determine whether there is "under-reporting" of taxes by omitting income or inflating deductions.

Employees have a low-risk profile because the "pay-as-you- earn" withholding tax system requires employers to deduct income taxes at source from employment income. In the majority of cases, the tax withheld is close to the employee's ultimate tax liability. In terms of statistical profiling, it does not pay the government to expend substantial resources in auditing employee tax returns unless there are other non-employment sources of income.

In contrast, self-employed individuals—for example, professionals and cash-oriented businesses—are deemed high-risk and, therefore, picked upon more frequently for audits. Within the self-employed group, the risk of under-reporting increases as earnings rise. So the CRA is much more likely to audit a person earning more than $100,000—about 2.5 percent of the population—than a person earning less than that amount. The incentive to under-report income varies directly with earnings.

From the taxpayer's vantage point, there are two distinct categories of audits: regulatory and criminal. In a regulatory audit, the CRA can demand that the taxpayer immediately produce all of his or her documents for examination. The taxpayer has no *Charter* rights and only minimal legal rights to protect against a regulatory audit. Indeed, quite the contrary: the law deems the minister's assessment correct unless the taxpayer can prove otherwise in a court of law.

In contrast, the law steps in quickly to protect an individual if the CRA conducts an audit for the purposes of laying potential criminal charges against the taxpayer. The law considers criminal charges as serious intrusions into the individual's liberty and protects taxpayers from unnecessary and over-extensive intrusions into his or her financial affairs.

In life, however, the line between routine regulatory audits and criminal investigations is blurred. After all, the only real difference between a regulatory and a criminal audit is the mind of the auditor, who must determine whether the evidence will lead to civil or criminal sanctions at the end of the audit process. Auditors cannot know with any certainty the fork in the road they will take until they have an opportunity to assess the evidence after gathering and examining *it*. *Thus*, invoking taxpayer *Charter* rights is often an ex-post analysis after the government lays criminal charges.

In theory, individuals should always ask at various stages of an income tax audit whether the auditor is conducting a routine regulatory examination or has any other purpose in mind. If the latter, the individual should immediately engage legal counsel and trigger *Charter* rights. Of course, asking the question may well raise the tax auditor's antenna as to the cause of the taxpayer's anxiety.

Tax avoidance is not going away. As governments collect ever-increasing amounts of revenue through taxes, the temptation for under-reporting increases, because taxpayers view the tax burden—about 10 per cent of Canadians pay 50 per cent of all income taxes—as unfair. So governments use increasingly more sophisticated statistical tests and computerized data to profile high-risk taxpayers who are likely to engage in evasion.

Ultimately, your chance of audit depends upon your risk profile.

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