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# THE PRACTITIONER'S VIEW

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Vol. 5, Issue 3 March 2004

## INCOME TAX SEASON ISSUE

### TAX SEASON – SOME MEASURES TO AVOID FUTURE PROBLEMS

The following article is based on articles printed in the March 2004 issue of News 'N Views, a publication of the Institute of Chartered Accountants of British Columbia (ICABC), and has been adapted with permission.

Most of you are heading into your busiest time of the year preparing and delivering hundreds of personal income tax returns. We'd like to remind you of a few simple and effective ways to help protect you and your clients from misunderstandings that do happen from time to time. These suggestions may seem quite basic but we continue to see a need for improvement in this area in a large number of offices that we visit.

#### Engagement Letters

Over the last few years we have seen more and more firms using engagement letters for their personal income tax clients. The coming into force of the *Personal Information Protection & Electronic Documents Act (PIPEDA)* has significantly heightened public awareness of the privacy issue and makes the implementation of a personal income tax engagement letter even more worthy of serious consideration. In addition to the obvious reasons, a T1 engagement letter is most beneficial when you are preparing the tax returns for different members of one family and shift deductions between spouses or between parent and child in order to minimize taxes payable. A sample T1 engagement letter has been prepared by the CICA for potential use and can be accessed at [http://www.cica.ca/multimedia/Download\\_Library/Standards/ASB/English/e\\_T1ltr.PDF](http://www.cica.ca/multimedia/Download_Library/Standards/ASB/English/e_T1ltr.PDF). ICABC has provided sample wording for additional paragraphs about privacy and confidentiality, which may be added to the sample CICA T1 engagement letter (**Appendix A**).

Most T1 software packages have the ability to generate engagement letters that can be customized to ensure you cover off the following items:

- Confidentiality of client information
- Responsibility of the client to provide accurate and complete information
- Responsibility of the client for the accuracy and completeness of the final return
- Use and distribution of your client's personal information
- Use and distribution of the completed income tax return

Appropriately prepared engagement letters can avoid potential future conflicts, which may ultimately lead to complaints of professional conduct. Recently, a client complained that a practitioner in Nova Scotia released confidential personal and corporate information to her family without authorization, despite the fact that the family members involved typically were heavily involved in her business and the CA viewed the family unit as a client, and had conducted themselves in this fashion for some time. Are you authorized to provide copies of a son or daughter's personal tax returns to the parent?

You should also remember that the engagement letters you have in place for your corporate clients need to be updated to address (a) the confidentiality of client information, and (b) client files are subject to practice inspection and review by people from outside the firm.

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*Practitioner's View is a regular publication of the Institute of Chartered Accountants of Nova Scotia to inform and to serve members who are involved in public accounting in Nova Scotia.*

## Income Tax Transmittal Letters

A properly written transmittal letter to your clients accompanying the income tax returns you prepare will serve to minimize the instances of discontented clients claiming that interest and penalties owing were caused by you not communicating the appropriate information to them. Many practitioners hold the view that such a letter is not necessary as they personally meet each client and go over all the issues that a good transmittal letter would cover. While this may be true, a hard copy of the letter in your file would provide permanent evidence of this discussion with your client in the event a problem arises at a later date, as well as serving as a handy reference for that client.

The letter can be your own or one that is included with your income tax return preparation software and should include the following items:

- The date, as evidence of when you communicated with and issued the Income tax return to your client. It is important to print a copy of the letter for your file as the return is issued, as most computer programs will automatically date the letter on the date printed should you choose to print it in the future.
- Filing instructions, including the due dates for the return being filed and for the payment of any balances owing.
- Installment requirements for the next taxation year.
- Information regarding balances carrying forward such as RRSP contribution limits and undeducted amounts as appropriate.

In addition, you may wish to discuss other issues such as your involvement, if any, with foreign asset reporting or specifically address the fact that a requirement does exist and that you have or have not done anything to meet that requirement.

Also, if you submit income tax returns for clients in paper form it is good practice to have a transmittal letter to Canada Revenue Agency (CRA). The letter should detail the types of returns being filed, the clients' names and identification numbers if more than one is being filed at a time. Further, it should be sent in duplicate so CRA can receipt one copy and return it to you as evidence of filing.

## File Storage

It is becoming fairly common for practitioners to not produce a complete paper copy of their clients' personal income tax returns for their own files. If this is the case, you should still print a copy of the transmittal letter as discussed above. In addition, the electronic version of each return should be saved in PDF. This will allow you to access the return without requiring the specific income tax software used to prepare it, which can also be hardware specific. It also ensures that changes cannot easily be made to the return and allows you to provide your client, or others as directed by your client (such as the bank), a complete copy of the return in electronic format.

Practitioners who attended the ICANS Practitioners Forum in October will also recall a demonstration by Wayne Taylor, Manager, CICA Information Resources Consultants (1-888-217-0039 [wayne.taylor@idisales.com](mailto:wayne.taylor@idisales.com)) of some exciting developments in software in this area. If you haven't already investigated this option, it may be too late for the current year, but it's something you might wish to add to your post-tax season list to take care of before next year! (CICA does not currently sell this product, but Doc-It™ and similar software are available in the marketplace).

## Have Appropriate Staff Confidentiality Agreements In Place

As discussed earlier in this newsletter, privacy legislation became effective all across Canada on January 1, 2004. While we have always advised practitioners to have confidentiality agreements with their staff, including contract staff, this legislation significantly increases the importance of such agreements. Their existence will allow you to establish, if required, that you have taken steps to protect your clients personal information as well as to serve as a reminder to your staff of the importance of maintaining the confidentiality of client information.

## Reducing Your Risk – Identifying Compilation Work

Finally, we would like to remind you that, except in rare circumstances, the preparation of a number of personal income tax forms such as self-employment and rental income schedules, are compilation engagements as envisioned by Section 9200 of the CICA Handbook. Copies of these schedules are frequently distributed by your clients to third parties for purposes such as financing applications. As a result, all pages of each schedule prepared and given to the client should have a Notice to Reader on them or refer to a separate Notice to

Reader. Most software packages will apply the Notice to Reader. In addition, your file should contain adequate support for the significant figures included both in the schedules and in the rest of your client's return.

## UPDATED DISABILITY TAX CREDIT CERTIFICATE

Remember that CRA has revised the Form T2201 used to claim the Disability Tax Credit (DTC). This revised form, which must be completed by a medical doctor or other qualified person, can be downloaded from [www.ccra.gc.ca/E/pbg/ft/t2201/README.html](http://www.ccra.gc.ca/E/pbg/ft/t2201/README.html). Old versions of the form should be discarded.

## HIDDEN COSTS OF TAX DISPUTES

*The following article appeared in the November 2003 issue of Public Practice Bulletin, a publication of the Institute of Chartered Accountants of Alberta and is reprinted with the permission of ICAA. The article is authored by Cheryl A. Gibson, B.Sc., FCA, J.D. - Fraser Milner Casgrain LLP.*

*Opinions expressed in this bulletin are those of the author and do not reflect the official position of ICAA.*

Accountants beware! The Canada Revenue Agency (CRA) is expanding the use of one of its most powerful tools: **the ability to require any person to provide information or documents about a named taxpayer**. In the absence of proper planning, accountants required to respond to CRA requirement letters (Requirements) may have to do so at their own cost.

In the past, the CRA generally restricted the use of Requirements to requests for documentation in the accountant's possession. However, the recent case of *MNR v. Kitsch et al (Tower)* reveals that the CRA is expanding the type of information it may seek through the issuance of Requirements.

In the *Tower* case, the CRA served Requirements on the accounting firm used by the individual taxpayers. These Requirements mandated the production of numerous documents including all of the accounting firm's files, notes of conversations or meetings, detailed telephone records and correspondence relating to the taxpayers. More importantly, the Requirements called for particular members of the accounting firm to answer questions. The individual taxpayers and the accounting firm sought to have the Requirements set aside.

The matter was ultimately heard by the Federal Court of Appeal of Canada (FCAC), which released its decision this past summer. Although the case dealt with a number of issues of importance to accountants, of particular interest was the issue of whether the accounting firm could refuse to answer the CRA's questions. There was no issue raised as to whether the accounting firm possessed the information necessary to answer the CRA's questions. **The FCAC held that not only was the CRA entitled to receive the information from the accounting firm but the CRA could specify the form in which the information was to be provided.**

The *Tower* case will, no doubt, encourage the CRA to use its power to issue Requirements more expansively in the future. Given this state of affairs, accountants should address with their clients, in advance, who will bear the costs that may be incurred if the accountant is served with a Requirement to answer questions or, worse, to create new documents to provide information within their knowledge in a format suitable to the CRA.

Another hidden cost is the pursuit of a tax matter through the appeals process. Where an accountant has prepared a tax return or has provided tax-planning advice, clients often assume that the cost of any dispute with the CRA will be borne by the accountant. To avoid any confusion in this regard, accountants should discuss the risk of a CRA reassessment with the client and ensure that a clear decision is made as to who will bear the cost of pursuing a tax appeal.

**By addressing the hidden costs of tax disputes with clients in advance, accountants can ensure that dealing with tax disputes will not result in a surprise negative effect on their bottom line.**

## DEVELOPING AN EFFECTIVE TAX MANAGEMENT PROGRAM

How effective is your tax management program? A significant portion of a typical practitioner's practice consists of tax work, which is an area of considerable exposure.

### Tax Management Standards

The Institute of Chartered Accountants of Alberta (ICAA) formed a Tax Task Force to develop a set of income tax standards. The Task Force established seventeen standards, that are grouped into 3 categories – "must have", "should have" and "desirable". These standards, listed in **Appendix B**, may be useful in implementing or improving a tax management program for your own practice.

Effective January 1, 2004, ICAA has made the review of a firm's tax management program a component of its practice review process. Other Provincial Institutes, including ICANS, are currently studying this issue.

### Tax Checklists – Corporate And Personal

ICAA has also developed tax checklists for use by practitioners, which are reproduced with permission. Corporate and Personal (versions 1 and 2) Tax Checklists are posted on the ICANS website at <http://www.icans.ns.ca/media/documents/PractitionersTaxChecklist.doc>. Practitioners who wish to use these checklists are cautioned that some modification may be necessary to replace references to Alberta.

## THE FISHING LICENSE ISSUE

There is little progress to report on this issue, which has significant potential impact on Atlantic fishers and their professional advisors. To date, ICANS has been unable to obtain a meeting with the Minister of Fisheries and Oceans. A senior CRA individual has advised that CRA has requested a legal opinion from Justice on the issue of using trust agreements for income tax purposes. Once that opinion is received, CRA will have discussions with DFO and senior CRA officials to determine ways, if any, to mitigate the tax consequences of the new policy. That official also indicated that CRA isn't prepared to meet before the legal opinion is in - but he did stress that no decision has yet been made on the issue of retroactive application of the new policy. However, he also indicated that it is clear that as of July 1, 2003, CRA's position is that transfers are no longer acceptable.

While local CRA representatives continue to be sympathetic to the issue, it is clear that the issue must be dealt with on a national basis.

## LINKS to CRA WEBSITE

In preparing for the upcoming tax season, CRA invites members to visit the following websites:

- Find out "What's New for 2003?" at [www.ccra-adrc.gc.ca/E/pub/tg/5000-g/5000-g-01-03e.html](http://www.ccra-adrc.gc.ca/E/pub/tg/5000-g/5000-g-01-03e.html).
- Download forms and publications by going to [www.ccra-adrc.gc.ca/formspubs/menu-e.html](http://www.ccra-adrc.gc.ca/formspubs/menu-e.html).
- Learn more about the "My Account" service for individuals at [www.ccra-adrc.gc.ca/eservices/tax/individuals/myaccount/menu-e.html](http://www.ccra-adrc.gc.ca/eservices/tax/individuals/myaccount/menu-e.html).

## CRA CONTACT LIST

For practitioner's convenience, an updated Canada Revenue Agency Contact List has been posted on the ICANS website at [www.icans.ns.ca](http://www.icans.ns.ca). Members are encouraged to call these senior managers and directors if they are having trouble resolving problems with CRA field staff.

## *SUGGESTIONS FOR OTHER TAX TOPICS FOR THE NEXT ISSUE?*

Contact **Wenda Bennett, CA** at the Institute [wbennett@icans.ns.ca](mailto:wbennett@icans.ns.ca) or (902) 425-3291.

**SAMPLE T1 ENGAGEMENT LETTER - ADDITIONAL PARAGRAPHS**  
(Drafted by ICABC, modified for use in Nova Scotia)

Note: the following paragraphs may be included in the sample T1 Engagement Letter provided by the CICA on their website at [http://www.cica.ca/multimedia/Download\\_Library/Standards/ASB/English/e\\_T1ltr.PDF](http://www.cica.ca/multimedia/Download_Library/Standards/ASB/English/e_T1ltr.PDF). (The additional information follows "Fees", replacing pages 5 and 6).

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By signing this letter, each family member agrees that I may retain personal information and any records containing personal information pending satisfaction of any outstanding accounts, even if a request is made under *Personal Information Protection Act* for access to that information.

**CONFIDENTIALITY**

I will maintain in confidence the information you give me. Accordingly, your personal information will not be disclosed to individuals outside my firm or used by anyone in my firm other than those who are involved in preparing your tax return(s) and/or providing related services, except:

- (a) with your consent;
- (b) as authorized or required by the *Personal Information and Protection of Electronic Document Act ("PIPEDA")*, or other law;
- (c) as authorized or required under the Bylaws and Rules of Professional Conduct of the Institute of Chartered Accountants of N.S., or other applicable professional obligations (see, for example, "PRACTICE INSPECTIONS" below); or
- (d) as set out below under "USE AND DISCLOSURE OF PERSONAL INFORMATION".

**PRACTICE INSPECTIONS**

In accordance with my professional obligations under the *Accountants (Chartered) Act* and Bylaws thereunder, my client files must periodically be reviewed by practice inspectors and firm personnel, to ensure I am following applicable professional and firm standards. Reviewers are required to maintain confidentiality of client information.

**USE AND DISCLOSURE OF PERSONAL INFORMATION**

You will provide the information I need to prepare your personal income tax return(s). By signing this letter, each family member (adult and minor children alike) consents to my use and disclosure of personal information as is necessary for the purpose of preparing your (and your family members') personal income tax return(s), including:

- (a) transferring personal financial information from one family member's return onto another family member's return, in order to maximize eligible tax credits, minimize taxes payable, or take advantage of deductions;
- (b) filing your (and your family members') tax return(s) with the Canada Revenue Agency; and
- (c) delivering your (and your family members') completed tax return(s) to you or any family member.

I may also use personal information to communicate with you and your family members and determine whether other accounting services may be of benefit to any of them, and, if so, to offer those services to them. If you would prefer I not send such communications, please so indicate below. [A space should be included in the Letter for the client to indicate this].

Personal information will be used and protected in accordance with my firm's privacy policies. If you would like a copy of these policies, please let me know [or contact my firm's Privacy Officer \_\_\_\_\_ at \_\_\_\_\_].

**LIMITATION OF LIABILITY** *(The wording below was provided by Glenn Urquhart, QC of Singleton Urquhart Scott at the ICABC Loss Prevention Seminar in June 1997 and then updated in September 1999. Contact the Professional Advisory Services Department for a copy of the complete presentation. This is an optional paragraph and covers your relationship with your client only, not with third parties.)*

The liability of (CA Firm) to you (and your family) for any claim related to professional services provided pursuant to this engagement letter in either contract, negligent misrepresentation or tort, including the partners, officers or employees of the accounting firm shall be strictly limited to the amount of any professional liability insurance the firm may have available at the time such claims are made. No claim shall be brought against the accounting firm in contract, negligent misrepresentation or tort more than three years (from date of Notice of Assessment) after the services were completed or terminated under this engagement.

If you have any questions about the contents of this letter, please call me. If the services outlined are in accordance with your requirements and if the above terms are acceptable to you, please sign this letter in the space provided and return it to me prior to my commencement in preparing your personal tax return(s). I appreciate the opportunity of continuing to be of service to you (and your family) in the preparation of your personal income tax return(s).

Yours very truly,

\_\_\_\_\_  
CHARTERED ACCOUNTANT

The services and terms as set out above are as agreed. As well, I acknowledge and accept my responsibilities as the taxpayer as outlined above. [This letter should be signed each adult and child in the family, including those children who may not be filing a return but whose information may be used in the preparation of a parent's tax return, unless the child is incapable to providing consent.

Date \_\_\_\_\_, 2004

Date \_\_\_\_\_, 2004

Date \_\_\_\_\_, 2004

Caution to Members

This sample letter is provided for illustrative purposes only. This is not an official position of the Institute. Members should revise the letter to suit their needs and their clients' circumstances. It is up to the members' professional judgment in how they wish to use this sample letter. Use of this sample letter does not guarantee that members are meeting their obligations under the *Personal Information and Protection of Electronic Documents Act*. Members who enter into engagements that involve collection, use, or disclosure of personal information outside NS, which could be governed by either federal privacy legislation or that of another province, should seek independent legal advice. As well, members are reminded that such a representation letter may or may not provide some evidence of due diligence on the part of the accountant. General legal advice is that the more generic the representation, the less useful the letter. More specificity would likely increase the benefit but would equally likely increase complexity of administration and cost. We wish to remind members that the Limitation of Liability clause in the sample letter applies to the relationship with your clients only, not to third parties. Members may wish to seek legal advice before deciding whether to include this paragraph in particular and prior to using this letter as a whole. Members may wish to obtain separate engagement and representation letters when they are performing a compilation engagement in conjunction with a tax return.

**TAX STANDARDS FOR A TAX MANAGEMENT PROGRAM**

(Developed by the Institute of Chartered Accountants of Alberta - May 2002)

**Public Accounting Firm (PAF) Resources – Required**

- 1 Professionals providing tax services must maintain and enhance their tax knowledge through training, reading and attendance in professional development courses and other appropriate medium.
- Professionals practicing tax and providing tax advice must have access to and must also maintain an up-to-date tax service.

**Compliance with Filing Deadlines - Required**

- 2 A system must be in place to ensure:
- a) compliance with filing deadlines
  - b) follow-up of CRA enquiries, correspondence, etc.

**CRA Form 183 – Required**

- 3 Client signed CRA Form 183 (authorization to electronically file T1) must be obtained.

**Client Tax History – Required**

- 4 Tax history must be maintained for new tax engagements, being copies of applicable returns, assessment notices and/or CRA printouts.

**Tax Filings Documents Review - Recommended**

- 5 Tax filings (T1s, T2s, elections, etc.) should be reviewed by an individual with appropriate tax experience. Documents should be reviewed for completeness and accuracy.

**Tax Software - Recommended**

- 6 Tax software should be used in the preparation of T1, T2, T3 and T4/T5 and similar filings.

**Disclaimer Statements - Recommended**

- 7 T1 and T2 financial information provided to parties other than CRA should contain disclaimer statements.

**Public Accounting Firm (PAF) Copy – Recommended**

- 8 a) Copies of filed returns should be retained as either hard or electronic copy, ensuring that electronic copies can be printed at any later date.
- b) Supporting documents utilized in the preparation of tax filings should be maintained or otherwise be readily available from the client.

**Client Copies of Returns or Summaries of Return Information – Recommended**

- 9 Copies of tax filings or summaries of return information should be provided to clients. The nature of these copies is at the discretion of the PAF considering the circumstances.

**Documentation of Services – Recommended**

- 10 a) There should be documentation of services to be provided for T1s (engagement letter recommended).  
b) There should be engagement letters or specific letters of understanding for all T2s and special tax work.

**Firm Address – Recommended**

- 11 Where the firm address is used as the client mailing address for tax filings, copies of correspondence from CRA should be provided to clients at the discretion of the PAF considering the circumstances.

**Bonus/Dividends – Recommended**

- 12 A system should be in place to ensure that appropriate withholdings and preparation of reporting documents is undertaken for bonuses/dividends by either the PAF, client or other party as may be relevant in the circumstances.

**Carry-Forward Amounts - Recommended**

- 13 Continuity balances of relevant and significant tax balances such as ABILs, capital gains<losses>, RRSP amounts, capital dividend accounts, CNILs, AMTs should be maintained.
- These balances can best be maintained with the use of computer software.

**Oral and Electronically Transmitted Tax Advice – Recommended**

- 14 Oral and electronically transmitted tax advice should be documented either as a memo to the file and/or as follow-up correspondence with the client.
- Alternatively electronic storage of E-mail transmissions should be maintained.

**Risk Areas – Recommended**

- 15 Appropriate procedures should be in place to:
- a. ensure ongoing referrals are performed as requested
  - b. provide appropriate communications to the client
  - c. ensure appropriate follow-up

**PAF Staff Checklists - Desirable**

- 16 Use of tax issues PAF staff checklists is desirable.

**Client Checklists – Desirable**

- 17 Procedures should be in place to ensure effective accumulation and completeness of information is provided by clients for completion of tax engagements.
- The use of client checklists is desirable.