

## **RED FLAGS FOR TAX AUDITS**

By

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Millions of employees forced to work from home because of COVID-19 turned their bedrooms, basements, and kitchens into workspaces. In doing so, they took on increased household expenses to do their jobs. The tax rules for employees claiming deductions are narrow and the CRA watches them carefully. Now, with tax filing season upon us, comes the hard part: CRA audits of employees who were not reimbursed by their employers for their home office expenses.

There are few things that individuals dread more than brown envelopes from the CRA. Almost inevitably, they contain bad news. Rarely do they include a refund cheque or thanks for contributing a substantial portion of one's income to the government's coffers. As we head into tax season, there are additional red flags this year that will lead the CRA to aggravate individuals, generally the most vulnerable, who claim home office deductions on account of expenses that their employers did not reimburse.

### **Who can Claim Relief?**

The government's rhetoric in announcing tax relief for employees was attractive. Employees can claim home office deductions on their personal tax returns if they used their workspace during Covid:

- *principally* to perform work from home; or
- *exclusively* to earn employment income on a regular and continuous basis for meeting (including video conferencing) clients, customers, or other people in the course of their employment duties.

Now comes the hard part. The CRA's internal policy is that "principally" means at least 50 percent and that the employee must have worked for at least four "consecutive" weeks due to Covid. Should the employee have kept a log of their time spent to establish that they worked at least 50 percent? Is physical presence in the workspace (kitchen) sufficient to constitute "work"? What if the employee worked for two stretches of three weeks with a break of one week in between? Do the six weeks satisfy the four *consecutive* weeks test? There is case law to suggest that it does not and the CRA will use it.

### **What is Eligible for Deduction?**

Deductible expenses include the following:

- Electricity
- Heat

- Water
- Utilities portion (electricity, heat, and water) of your condominium fees
- Home internet access fees
- Maintenance and minor repair costs
- Rent paid for a house or apartment
- Office supplies like pens and paper, and cell phone minutes.

Employees must allocate their usage between work related and personal usage. They can do based upon square footage or time allocation. For example, if the home office is 20 percent of the home, it would be reasonable to allocate 20 percent plus an amount for common areas to the office. Internet fees and electronic communications would require time allocation.

### **What is Excluded?**

Employees cannot deduct capital costs for office chairs, mortgage interest and property taxes, even if some portion of the costs pertain to the home office (the government did expend \$5 million to supply its own employees with chairs) even though independent contractors can.

### **How to Claim Expenses?**

There are two methods:

#### **1. Simplified method**

Employees who worked more than 50% of the time from home for a period of at least four consecutive weeks in 2021 due to the COVID-19 pandemic can claim \$2 for each day they worked from home during that period to a maximum of \$500 (250 working days) per individual.

Under this method, the employee does not need to calculate the size of her work space, keep supporting documents of expenses or get her employer to complete Form T2200.

#### **2. Detailed method**

Under this method, an employee can claim the actual amounts paid. However, she must support her claims with documents and complete Form T777S or Form T777 and get her employer to complete and sign Form T2200S or Form T2200.

Employees using this method should retain their records and expect to be audited by the CRA.

## **Procedure on CRA Audit?**

When the CRA assesses an employee, it is up to the employee to support her claim by whatever records she can muster, which may be two or three years down the road. No records, no deduction. The CRA's assessment is deemed to be correct. Viewers of *Law & Order* should get it out of their minds that taxpayers are innocent until proven guilty. In tax law, the Minister's assessment is deemed to be correct unless the taxpayer establishes that it is not.

When the CRA assesses, taxpayers should remember to file a Notice of Objection within 90 days of the mailing of the assessment even if they are in discussions with the auditor. Do not wait for a quick resolution of the matter. There is no such thing as a "quick resolution" in tax law.

Keep an eye out for the brown envelope. In most cases, taxpayers will be eligible for the Informal Procedure at the Tax Court, where they can file a Notice of Appeal. You should do so promptly and within 90 days of the Minister's confirmation of your assessment. If you go on vacation have a neighbour check your mail. You will lose your right to appeal if you miss the 90-day deadline. There is no equity in tax law. The entire matter should be cleared up within 3-4 years or so!

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