

3 Hidden Costs of Not Declaring Income to Save on Taxes for Small Business Owners

By Agnes Leung, October 26, 2018

Restaurants that have cash-only signs. Servers who don't declare all of their tips. Contractors who offer a lower cost if a job is done with no contract. They all play a part in Canada's "Underground Economy", and they all have their own reasons for avoiding taxes.

Canadians have different heritage. Some come from countries with less government and less taxes, where each person counts on their own hard work to survive and thrive. We already pay so many taxes here, why pay more? While it may be tempting to "save" on taxes and GST, getting caught by the Canadian Revenue Agency (CRA) isn't the only bad thing that can happen to small business owners.

As a Chartered Professional Accountant (CPA) and Chartered Business Valuator (CBV), I have come across these three scenarios in my practice. Besides large fines, jail time, and even a criminal record, not declaring full income will cost you when:

1. You are injured in an accident and someone else is at fault
2. You want to get a mortgage or a loan
3. You want to sell your business

Personal Injury Loss

When you have the misfortune of slipping on ice or being in a car accident, your injuries may leave you out of work and in pain for the rest of your life. If you can't go back to work at all or work as much, what will happen to you, your family, and your business?

When you are injured at someone else's fault, you deserve compensation. The first thing you should do is to contact a lawyer. There are many wonderful personal lawyers who can help you get your medical benefits and loss of income claim, and they will likely hire a financial expert like myself to calculate your personal injury economic loss claim.

To do this, we usually begin by looking at your old tax return records. While writing off unreported expenses and not reporting all your cash transactions means you get taxed less, this lower total income amount also means you will get less compensation for lost wages in your injury claim. If you can't show that you made that much before the accident, then you can't show that you lost that much after the accident. This becomes a huge amount to lose when it is calculated over the rest of your working life.

For more on this topic, see our article on economic loss claims.

Getting a mortgage

Most people don't pay cash to buy a house; most often, they will need a mortgage. Lenders will likely ask for some proof of your current salary if you are employed, or Notices of Assessment from the Canada Revenue Agency for the past two years².

If you have no reported income, salary, business, or dividend, banks will likely reject your mortgage application.

Selling your business

Business owners pour blood, sweat and tears to start and grow their company. One day, you will be ready to retire or start something new. In order to sell your business for the best payout, you will need to show that your business is profitable.

There are different ways to measure how much a business is worth. When a business changes hands by selling off its hard assets (property, equipment and inventory), it is often worth less than when it sells as a "continuing business" (one that can keep operating). A Chartered Business Valuator is a specialized professional who can determine the value of your business and/or your interest in a joint venture or partnership. To value the business, we look at its past income statements. If your business income is low because it is under-reported, your business will look like it is worth less than it should be to investors and buyers—and you will not get the full return that you deserve.

Fortunately, the CRA offers the Voluntary Disclosures Program, giving anyone a second chance to correct previously filed tax returns or to file a return that should have been filed. As long as you do so before the CRA takes action against you, you won't be prosecuted or in some cases even fined.

If you have more questions about Canadian income tax laws and how they apply to your business, you can contact me for more information or for help with your income tax returns.

Disclaimer

I do not work for the CRA and am not pro-government, but have a keen interest for financial literacy and independence.

² <https://www.canada.ca/en/financial-consumer-agency/services/mortgages/preapproval-qualify-mortgage.html>

<https://alcpavaluations.com/undeclared-cash-income>