KEEPING BUSINESS RECORDS IN AN ELECTRONIC AGE

All businesses operating in Canada, from multinational corporations to the smallest start-up, are required to keep business records recording their income, expenses, and, ultimately, the profits on which they will be taxed. Traditionally, such records were kept in paper format, through ledgers and journals in which entries were made by hand. Those traditional methods are, of course, giving way (or perhaps have already given way) to the use of spreadsheets, accounting software, electronic purchasing, and inventory control systems and tax return preparation software.

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The move to electronic record keeping has meant, of course, that the Canada Revenue Agency (CRA) has had to adapt its rules on required record keeping to address this reality. When it comes to the basic rules around business record keeping requirements, however, not much has changed. This article summarizes those basic rules which apply to all business record keeping, in whatever format, as well as the newer rules developed to address electronic record keeping by businesses.

The Basic Rules of Business Record Keeping

There are no exceptions to the rule which requires anyone who carries on a business or engages in commercial activity in Canada to keep accurate records of their business or commercial activities. And, even if such a requirement wasn't mandated by law, it would just make business sense. Every business needs to have an accurate understanding of its inventory, expenses, revenue, and, ultimately, its profits. And any business which doesn't do so is very likely headed for failure. As well, it's impossible to fulfill a business's tax filing obligations without that information. Business expenses which can't be documented in some way can't be claimed as a deduction from business income, and business tax credits can't be claimed without supporting documentation. Finally, nearly all businesses must seek external financing at some point, whether through loans from banks or other lenders, or by the sale of shares in the business. No one is likely to lend to or invest in a business which can't provide an accurate accounting of its current financial state.

The CRA does not mandate any particular form or structure for business record keeping. Rather, as outlined in the CRA guide on the subject, the Agency requires that whatever the methodology, the records kept by a business must:

- be reliable and complete;
- provide the taxpayer with the correct information needed to enable it to meet its tax obligations and to calculate any credits to which the business is entitled;
- be substantiated by supporting documents to verify the information contained in the records; and
- include other documents, such as appointment books, logbooks, income tax and GST/HST returns, scientific research and experimental development (SR&ED) vouchers and records, and certain accountants' working papers, that assist in determining the businesses obligations and entitlements.

Where the business in question is an incorporated one, additional record keeping requirements are imposed. Corporations must keep records of the minutes of meetings of the directors of the corporation and all shareholders' meetings, must keep an accurate record of who owns the shares of the corporation and any transfers of those shares. And, no matter what the business structure, where an individual, partnership, or corporation operates more than one business, separate records must be kept for each one.

The CRA recognizes that we are, in effect, in a period of transition in which the traditional method of paper record keeping is being supplanted by electronic records. The Agency is therefore prepared to accept books and records which are prepared in either or both methods. Specifically, the CRA accepts records prepared and retained entirely in a paper format, those which are produced on paper and subsequently converted to and stored in an electronically accessible and readable format or electronic records, and supporting documents which are produced and stored entirely in an electronic environment. However, no matter what format is used, supporting documents (i.e., purchase invoices, cancelled cheques, bank deposit records, work orders, credit card slips) for those records must also be maintained and kept in either a paper or electronic format.

How Long Must Records be Kept?

The general rule for record keeping requires that business records be kept for six years after the end of the last tax year to which they relate. Therefore, as an example, business records pertaining to the 2016 tax year must be kept by the business until the end of 2022.

As with most things tax-related, there are special circumstances in which different rules apply. If a business's income tax return for a particular year is filed late, then the records relating to that return should be kept until six years from the date of filing. Similarly, if a notice of objection or appeal has been filed with respect to the CRA's

assessment of a business tax return, the records relating to that objection or appeal should be kept for six years after the objection or appeal is disposed of or the time for filing of a further appeal is expired, whichever is later.

Special rules also apply where an unincorporated business closes or a corporation is dissolved. In the former circumstance, business records must be kept for six years after the end of the tax year in which the business ceased to function. In the latter, records for a dissolved corporation must be kept for two years after the date of dissolution. Finally, where a corporation amalgamates or merges with another corporation, business records must be kept as if the newly formed corporation was a continuation of each of the original ones—in other words, even though a new corporation has been created by the amalgamation, records relating to the two original corporations must nonetheless be maintained for the time periods which would have been required if those two original corporations were still in existence.

Early Destruction of Business Records

It may happen that a business owner wishes to destroy the records of a business earlier than the time period mandated under the rules outlined above. Such destruction is possible, but only with the permission of the CRA. Such permission can be obtained in either of two ways: an application can be made to the business's Tax Services Office (a listing is available on the CRA Web site at www.cra-arc.gc.ca/cntct/tso-bsf-eng.html), or the business owner can complete and file Form T137, Request for Destruction of Books and Records, which is also available on the CRA Web site at www.cra-arc.gc.ca/E/pbg/tf/t137/t137-15e.pdf.

Where Must Records be Kept?

Before the advent of electronic record keeping, this is a question which would have arisen infrequently, and usually only in the context of a multinational business. For the most part, paper records were kept on the business premises, or perhaps in the office of the bookkeeper or accountant who kept the books and handled the payroll. That, of course, has changed with the implementation of electronic record keeping, which allows business records to be stored on a server located literally anywhere on the globe. Notwithstanding, the rule remains that business records, in whatever format, must be kept at the place of business or the business owner's residence in Canada, unless permission is obtained from the CRA to store those business records outside Canada. Such permission must be requested, in writing, from the nearest Tax Services Office. No particular form is prescribed for the obtaining of such permission.

Even where permission is obtained from the CRA to store business records outside Canada, the business is responsible for making those records available for review by CRA representatives in Canada when such access is requested. Alternatively, the business can incur the cost of having CRA representatives travel to the location outside Canada where the business records are kept.

As might be expected, particular rules apply to determining the location of business records kept in electronic format. Specifically, the CRA takes the position that such records kept outside Canada and accessed electronically from this country are not considered to be records kept in Canada, as required. The CRA does, however, provide an administrative concession to assist a business which is in this position. Where the CRA has given a business permission to maintain electronic records outside Canada, the Agency will accept copies of those records for review purposes if:

- the CRA is satisfied that the copies of the records are true copies;
- the records are made available to CRA officials in Canada in an electronically readable and useable format; and
- the records contain adequate details to support the tax returns filed with the CRA.

Keeping electronic business records

For the most part, the rules outlined above with respect to business record keeping apply equally to paper and electronic record-keeping methods. The CRA has, however, needed to develop rules which apply specifically to the keeping of business records by electronic means.

Where records are kept in paper format, they are accessible to anyone who has the business and/or accounting knowledge to understand them. Where the same records are kept by electronic means, that may not be the case, depending on the types of hardware and software used, and the format or medium in which records are stored. Most of the CRA's rules specific to electronic record keeping, therefore, address issues relating to the accessibility and readability of those records by CRA officials using readily available software. Where records are kept in electronic format they must, in addition to satisfying the general requirements outlined above, comply with the following rules specific to electronic record keeping:

- any electronic record keeping system must have the capacity to capture, produce, and retain sufficient details to determine the tax obligations and entitlements of the business;
- any computerized records must be supported and maintained by a system capable of producing records that are accessible to CRA officials and readable by CRA software;
- such records must be kept in an electronically readable format even if the business retains paper copies of those electronic records, and the original electronic supporting documents have been transferred to another medium such as microfilm or a scanned image;
- the business owner must maintain proper backup records at all times and, preferably, store them at an off-site location within Canada;
- the electronic records of the business must be retained in an electronically accessible and readable format even if changes have taken place to the operating and/or electronic business system used by the business;
- if any of the electronic records which the business is required to maintain are lost, destroyed, or damaged, the business owner must contact the CRA's business enquires telephone line at 1-800-959-5525 to report that development, and must recreate the files within a reasonable period of time; and
- if business records have been encrypted, it must be possible for them to be decrypted and produced in an accessible and electronically readable format to CRA officials.

Some of the terminology used by the CRA in outlining its record-keeping requirements can be found on the CRA Web site at www.cra-arc.gc.ca/tax/bsnss/tpcs/kprc/menu-eng.html. As a practical matter, however, the emphasis throughout is on maintaining electronic records which not only capture the information needed to determine the tax obligations of the business, but that do so in a format which is readable using readily available industry standard software

and commonly used data interchange formats, and any other electronic record keeping issues. It goes without saying that the use of proprietary software which is not accessible to anyone not possessing that software would not be acceptable to the CRA, nor would a situation in which encrypted records are protected by a password or passwords which cannot be made available to the CRA.

In order to ensure that these requirements are being met on an ongoing basis, the CRA has the right to undertake a review of the business systems employed by any business operating in Canada, and any business owner is obliged to provide information to the Agency, on request, with respect to those business systems. For its part, the CRA will provide business owners with any needed information on the types of electronic file formats that are compatible with CRA software, including non-proprietary, commonly used data interchange format. That information can be obtained by calling the CRA's business enquiries line at 1-800-959-5525.

Payroll and sales tax records

The rules outlined above apply specifically to the maintenance of business records needed to determine a business's income tax obligations. Nearly all businesses must also maintain records with respect to their payroll obligations and the goods and services and harmonized sales tax implications of business transactions. And, while the contents of the records may be different, the same general rules on how records must be created, maintained and made available to the CRA, in whatever format, apply equally to payroll and sales tax records.

Conclusion

Few business owners like to spend time on the intricacies of record keeping or maintenance, when their energies could be better spent on core business functions. Many business owners contract such functions out to third-party providers, and there's nothing wrong with that approach. However, it must be remembered that, no matter who prepares and maintains the books, the business owner remains responsible for the contents of those records.

While it may seem that complying with the CRA's requirements with respect to record keeping is unduly time-consuming and onerous, most of the time and effort involved is in setting up record-keeping systems and processes when the business is started or, perhaps, when an existing business converts to electronic record keeping. Once that upfront work is accomplished, and proper systems are put in place, the amount of time and energy required is minimal by comparison to the benefits which will accrue to the business from having those systems in place.