A Most Taxing Risk
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On April 21st, 2010, I will be delivering a Webinar of particular interest to Ontario- and BC-based charities and other nonprofits, *Getting Ready for the HST* (register here). While preparing for that, however, I got to thinking about tax from a risk management perspective, and realized that it is a very useful way of thinking about the work involved in complying with various taxation requirements.

The focus of this month's article, then, is just what are the risks associated with various taxation requirements (with a timely focus on GST or HST).

A nonprofit can wear many hats when it comes to GST and other taxes, and there are risks associated with each one. For example, a nonprofit can be a:

- tax collector,
- tax payer,
- tax rebate recipient,
- tax auditor (!), and
- tax remitter.

Let's explore these many roles and see what risks come along with each.

Tax Collector

In many cases, your organization will not charge GST on your sales of goods or services, though you may in certain cases. In these cases, you are a tax collector! What are the risks that go along with this job? They include the risk of:

- collecting too much tax from a customer or client (in which case you may have to refund the tax to them, and possibly also remit it to the government); or

- collecting too little tax (in which case you are liable to the government for that tax, and have slim prospects of recouping this from your client).

So, whether you over- or under-collect, it really is a lose-lose scenario!

Tax Payer

Like most of us, you'll typically have to pay GST on goods and services (that aren't exempt from tax). Strictly speaking, if you underpay the tax, you are liable for it, though it may be difficult for the seller (the tax collector from above) to get it from you. There is also, of course, the risk of overpaying, if you or the vendor miscalculate the tax owing, or don't understand what items should be tax exempt.

Tax Rebate Recipient

Many nonprofit organizations will be eligible for a rebate of some portion of the GST they've paid on purchases of taxable goods and services (for example, charities typically at 50%). This can be a significant amount for some organizations, so it is well worth filing for rebates. The risks here include:

- failing to file (no filing, no rebate!);
- late filings (giving rise to delayed cash flow, or ... no rebate); and
- incorrect filings (incomplete or incorrect information could delay processing or result in incorrect rebates).

On this latter point in particular, there is a significant underlying issue: adequate accounting records. Properly accounting for GST, including the amounts collected, paid and rebated, can, quite frankly, be a nightmare!

Even a small organization can have thousands of transactions in a year, and each transaction can have its own GST issues. Most transactions, and the GST on them, are pretty small, of course, and a very occasional, tiny error is hardly the end of the world. But those small transactions come in a never-ending torrent, and it is critical that your systems and procedures be up to the task of accurately recording the GST implications of each transaction. You surely don't want to have to manually adjust every little transaction for its GST, so having systems in place to manage this is really the only option to be compliant.

Tax Auditor

What's this, you ask? We have to audit ourselves? Well, no. But, you do have certain responsibilities -- let's say in collecting taxes -- where you almost have to have an auditor's mind. For example, if a purchaser of taxable goods or services claims to be exempt (for example, certain governments and status Indians), you are responsible for ensuring that it is so. This is probably as "simple" as obtaining the "appropriate documentation", which you'll need to understand. The risk of failing to ask for, obtain, and understand this documentation can go right to your bottom line!

Tax Remitter

The final hat you might be wearing relates to remitting taxes you've collected (or otherwise been assessed). Taxes collected on behalf of the Government are generally viewed to be held in trust, and the responsibility to remit on a timely basis is taken very seriously by the Canada Revenue Agency (CRA).

Of course, one risk is that of over-remitting, or paying too much. Now, you may be able to get that overpayment back ... eventually ... if you find your error. In the meantime, you are out of pocket that cash, with little to show for it. And, as suggested, if your accounting records are such that you fail to find your error, you'll likely be out of pocket this amount permanently.

On the other hand, the risks of failing to remit when required, or failing to remit all that is owing, are significant. In the first instance, of course, there can be interest and late payment penalties, but beyond that, the liability for amounts owing can actually be borne personally by the directors of an organization.

It is also important to note that this issue -- personal liability of directors -- as significant as it is, applies not only to taxes collected such as the GST, but also to various types of employee withholdings, such as employee income taxes, CPP, and EI contributions.

While it has entered the mind of many an organization that these funds might be a good source of short-term (or longer!) financing, the costs and other risks of using them as such can be extreme indeed.

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The many risks that are briefly outlined above will hopefully make clear the need to pay adequate attention to your organization's compliance with taxation requirements. And, while senior management and board attention to matters such as timely remittances, filings and CRA audits is necessary, it is not sufficient to ensure overall compliance.

Proper accounting systems, processes and procedures, right down to the individual transaction level, are essential to being able to achieve an adequate level of compliance with these requirements. Far from being simply "overhead" or "administration", tax compliance is one reason (of several) why adequate books and records, and the systems that maintain them, are ultimately the difference between continuing to operate and not. And, proper accounting systems can pay for themselves, in terms of avoiding the costs of noncompliance, including penalties, interest, potential lost rebates, and refunds, not to mention the time and stress of a CRA audit and potential personal liability of the organization's directors.

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