

Behind the Counter

The Underground Economy and Tax Evasion

The underground economy has many names. It is known as the 'black market', the 'hidden economy', the 'irregular economy', the 'shadow economy' and the 'subterranean economy'. There are usually two participants to the transaction, the seller who normally sells for cash, so there is no record of the transaction and the purchaser who is interested in getting a 'deal' and pays cash. These transactions may be from illegal activities such as sale of stolen goods, tobacco, alcohol, drugs, prostitution, software piracy. Or they may be the result of legal activities such as underreporting self employment income, capital gains or dividends or failing to report goods transported over the border. These transactions are considered tax evasion which is illegal.

Most people won't deliberately go out and participate in the underground economy until the opportunity presents itself. One school of thought is that the person is making a rational business decision with the aim of getting the best bang for the buck. The other point of view is that people participate in the underground economy when they convince themselves that paying taxes is unfair and when they feel cheated by government. When they feel this way, they feel that it is ok to cheat back.

The underground economy was introduced to the public eye in the 1990's when there was widespread tobacco smuggling and the GST was introduced. The reason it was discovered was that Canadians started to use more bills and coins so the Royal Canadian Mint was producing more.

Over time, CRA has targeted several sectors of the economy and focused on auditing those sectors. In the restaurant trade, they focused on unreported tips and tampering with cash registers. In the automotive sector, they focused on unreported car repair income and sales of automobiles by unlicensed businesses. In the jewellery sector, the focus was on smuggled precious gems and craftspeople who sell directly to consumers. The largest sector for underground activity has been the construction industry where services can be exchanged with basically no trace. Here the government instituted the requirement to file T5018 slips for all construction companies that use contractors. They also provided information to the consumer about the risks of having work done without a written contract.

The introduction of the Home Renovation Tax Credit is an innovative way of catching those contractors that have been avoiding tax and also makes the government look benevolent. This year, CRA will have a

record of everyone who participated in the renovation program and if that does not match with the revenue reported by the contractors, I can foresee many audits on construction businesses.

The way that the CRA deals with these acts is to determine whether or not the person is 'living beyond their means' and if they have a large property registered and many vehicles, but show no taxable income, then the CRA will most likely audit. CRA also encourages people to come forward and voluntarily disclose any income they may have made and not disclosed previously.

If you are caught participating in the underground economy as a seller and convicted by CRA you could be subject to a fine between 50% and 200% of the evaded tax and a possible 2 year jail term in addition to any other penalties that the CRA might assess. You will probably lose your business and possibly lose your home.

Many people believe that if they participate in this hidden economy that they are not hurting anyone but themselves, but as this economy grows, the burden of those evading the tax is put onto those of us who pay taxes. With less taxes being paid more government programs will need to be cut, such as health care, child care, employment insurance and pensions, not to mention grant funding for other programs such as sports and the arts.

Then as a small business owner, how are you going to compete with someone else in your field that doesn't pay taxes? That is called unfair competition and these people are actually driving the economy of BC and Canada downward by not following the rules. Think about it, your business can't compete, it goes under, you need to let your staff go, more people on the street.....etc.

How do you fight this economy? Pay by cheque, credit card or debit card, so there is some sort of paper trail. Choose licensed contractors to do your construction and renovation work. Make sure that you get a written contract before the work is started to protect you if things go wrong. Demand an invoice. Pay the taxes that you owe on your own purchases and report all of your income in compliance with the income tax act. Use your accountant and financial planner to help you plan for 'tax deferral' as opposed to 'tax evasion' which is illegal.

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