

Tax

COVID-19 benefits: fraudulent claims, tax fraud and cash economy | David Rotfleisch

By David Rotfleisch



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(June 26, 2020, 11:50 AM EDT) -- The COVID-19 Canadian Emergency Wage Subsidy (CEWS) application forms and Canadian Emergency Response Benefit (CERB) application forms were put together in such blinding haste in April that U.S. aerospace engineer Edward Aloysius Murphy Jr. would have rolled his eyes in disgust.

The creator of "Murphy's law" knew what he was talking about: "Always assume the worst-case scenario," "If anything can go wrong, it will," and "Things get worse under pressure."

Both the CEWS and the CERB application forms were severely flawed from the outset. How? The government did not ask for the right information upfront — information that was readily available and should have been requested on the application forms themselves.

I remember looking at the actual forms and thinking that this oversight will lead to tax fraud and support the underground economy. I'm not clairvoyant; I'm just a Canadian tax lawyer who is getting long in the tooth.

As of June 25, there have been 361,000 repayments made to the Canada Revenue Agency (CRA) by taxpayers for CERB claims they weren't eligible for. Further, CRA is looking into tips it received about fraudulent COVID-19 benefits: the number of fake claims has risen from 600 on June 1 to 3,300 by June 25.

Now, there are even reports that organized crime has become involved to turn CEWS and CERB into convenient cash cows.

In its haste to get money to Canadians quickly, government bureaucrats forgot to ask for very simple business information that would have prevented fraudulent claims and tax fraud. Every business has to have computed the revenue reduction to determine its eligibility for CEWS:

- A revenue reduction of 15 per cent for the March to April 2020 period, compared to March to April 2019.
- For subsequent periods, there has to be a 30 per cent revenue reduction compared to the previous year.
- Revenue amounts for the current month and for the comparable month last year.
- Total wages paid and number of employees for previous months.

None of this simple and important information was asked for on the application form. Instead, a business must submit the form indicating how much it paid in wages and how much it is claiming as a subsidy.

When CRA finally gets around to auditing amounts paid out for bogus CEWS claims, fraudsters will be nothing but a dust cloud on the horizon.

Those companies that are still operating will be subject to a 25 per cent penalty if CRA can prove that they wilfully gamed the system. And as Canadian tax lawyers, we will represent those taxpayers and vigorously defend them, some no doubt successfully. A handful of others will, probably, go to jail.

At the end of the day, we the taxpayers will be paying for this program via tax increases and we'll be out-of-pocket hundreds of millions or billions of dollars.

Less and less reported 'on the books'

For businesses that participate in the cash economy, the revenues they previously reported were, of course, lower than they should have been, which that means showing the necessary revenue reduction becomes more difficult. They will report even fewer sales on the books and do more unreported cash sales.

So, the CEWS ends up providing further incentives to participants in the underground economy to increase rather than decrease or eliminate their tax evasion. Once the economy recovers from the COVID-19 shutdown they may, or may not, increase their reported sales back to previous levels. This Canadian tax lawyer suspects once they get used to the increased unreported cash, they will become addicted to it and will continue to leave the new, larger portion off the books.

While the problem of unreported cash sales and the underground economy is an ongoing focus of CRA, the CEWS will have the unintended consequence of supporting the underground economy. This probably cannot be avoided.

However, the incentive for massive tax fraud fuelled by lack of basic information gathering on the application forms and lack of appropriate penalties in the original rules is scandalous and unforgivable.

Tax fraud with Scientific Research Tax Credit, GST

This is not the first time that the government has handed out money to taxpayers with effectively no controls. The Scientific Research Tax Credit (SRTC) program allowed outside investors to claim tax credits for investments made into companies that were purportedly carrying on scientific research.

There was no control over the use of the funds invested and over \$1.6 billion in tax relief was provided to outside investors between 1983 and 1985 — which is the year in which the measure was abolished when it became clear to the government that funds were not, in fact, being used for scientific research.

When the GST program was introduced, there was similar tax fraud. Taxpayers who claimed refunds were sent cheques with no verification of the claims whatsoever. Subsequent tax audits revealed massive fraud, and in many cases, the government was unable to recover improper payments since the payees had disappeared. Poof!

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