

# Cash Economy An Investigative Approach

OECD Asia-Pacific Academy for  
Tax and Financial Crime  
Investigation

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# Objectives

- Mandate of the Canada Revenue Agency (CRA) and the Criminal Investigations Program
- CRA's strategy to tackle the cash economy
- Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)
- Investigative strategies for the cash economy
- Case Studies

# Canada Revenue Agency (CRA)

## Mission, Vision, and Values

### **Mission**

Administer tax, benefits, and related programs, and ensure compliance on behalf of governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians.

### **Vision**

A world-class tax and benefits administration that is trusted, fair, and helpful by putting people first.

### **Values**

Integrity

Professionalism

Respect

Collaboration

# Mandate of the Criminal Investigations Division

## Criminal Investigations Program (CIP)



Ensures significant cases of tax evasion and other serious violations of the tax laws are investigated and, where appropriate, referred to the Public Prosecution Service of Canada for possible criminal prosecution.

## Illicit Income Audit Program (IIAP)



Undertakes income tax and goods and services tax/harmonized sales tax (GST/HST) audits of individuals and other entities that are involved in, or, are suspected of, engaging in illicit activities. The IIAP ensures that income from these activities is subject to the appropriate taxes and is recovered swiftly to reduce the risk of financial loss to the government.

## Illicit Income Program vs Criminal Investigations Program

	Illicit Income Program (IIAP)	Criminal Investigations Program (CIP)
Classification	Audit – civil	Investigation - criminal
Evidence	Requirement for Information	Production Order, Search Warrant
Onus of Proof	Taxpayer	Crown
Method of Proving Income	Direct/Indirect	Direct/indirect

## Cash – Why do people use it?

### Group Sharing

Please spend 15 minutes within your group discussing the different reasons why people would use cash rather than another form of payment in your country.

# Importance of Investigating Cash Economy

- Ensure tax system is fair for everyone
- Ensure businesses are competing on a level playing field
- Ensure the government collects the proper amount of tax revenue

# CRA's Underground Economy Strategy

- Uses a model of three pillars to minimize the underground economy related tax non-compliance



Identify Activities



Prevent Activities



Address Activities

Source: Canada.ca Website - [2022+ Underground Economy Strategy](#)

# Source of Referrals to Criminal Investigations Program

- Internal – audit programs, collections, internal affairs
- External – law enforcement, regulatory agencies, financial institutions, leads (tipsters and confidential informants), international partners
- Self-generated – media, intelligence section

# Operational Partnerships

## Domestic partnerships

- The Royal Canadian Mounted Police (RCMP)
- The Canada Border Services Agency (CBSA)
- Municipal and provincial police forces
- Financial Transactions and Report Analysis Center of Canada (FINTRAC)

## International partnerships

- [Joint Chiefs of Global Tax Enforcement \(J5\)](#)
- International tax enforcement authorities
- Simultaneous Criminal Investigation Program (SCIPs)

# Financial Transactions and Reports Analysis Center of Canada (FINTRAC)

- FINTRAC is Canada's financial intelligence unit (FIU)
- Contribute to the public safety of Canadians and help protect the integrity of Canada's financial system through the detection and deterrence of money laundering and terrorist activity financing.
- Mandated by the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* to provide operational support to our domestic and international law enforcement and intelligence partners and to give strategic advice to the Government of Canada.
- Receives about 20 million reports from approximately 31,000 sources in a variety of Canada business sectors.

Source: Canada.ca website [Sharing Intelligence, Making the Links](#)

# Financial Transactions and Reports Analysis Center of Canada (FINTRAC)

## Reporting Entities

- Reporting entities that must report certain transactions to FINTRAC
  - Accountants and accounting firms
  - Armoured car business
  - Casinos
  - Dealers in precious metals
  - Financial entities
  - Money service businesses
  - Mortgage administrators
  - Real estate brokers
  - Securities dealers

Source: Canada.ca website: [Sharing Intelligence, Making the Links](#)

# Financial Transactions and Reports Analysis Center of Canada (FINTRAC)

## Type of reports

- Suspicious Transaction Reports (STR's)
- Large Cash Transaction Reports (LCTR)
- Casino Disbursement Reports (CDR)
- Cross Border Reports

# Suspicious Transaction Report (STR)

## Group Sharing

Please spend 20 minutes within your group discussing the STR that was received from an FIU. Based on the information contained in the STR, what information would you want to know to determine if further investigative work should be conducted.

## Legislative Changes

To promote program success

- Integration into the anti-money laundering and anti-terrorist financing regime
  - Designated offence
  - Increased information sharing to police

# Challenges Investigating Cash Economy

- Investigation periods occur in the past
- Source of the cash – is it from a taxable source?
- Establishing a proper baseline for a net worth
- Witnesses not cooperative

# Verification of Income

## Direct Method

- Supported by direct evidence
- Can be corroborated with an indirect method
- **Proves** a fact

## Indirect Method

- Supported by direct evidence
- Can be corroborated with an indirect method
- **Infers** a fact exists

# Verification of Income

Which method is appropriate?

## Direct Method

- Specific Items

## Indirect Methods

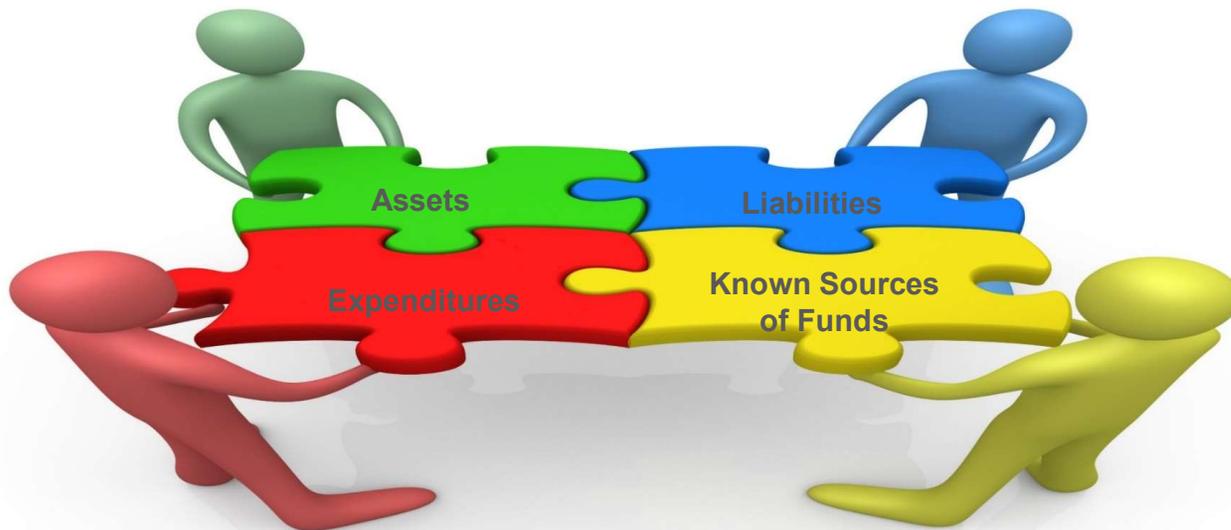
- Net Worth
- Expenditures
- Cash
- Bank Deposits
- Projections

What should we consider when deciding what method to use?

# Indirect Verification of Income

What is a net worth analysis?

A Net Worth Analysis is an indirect method of determining an individual's income earned through illicit means. The Net Worth Analysis quantifies the illicit income by analyzing the following:



# Indirect Verification of Income

Why use a net worth analysis?

A Net Worth Analysis can assist an investigator in quantifying the amount of illicit income earned by an individual over a specified period of time.

A Net Worth Analysis can be utilized when:

- Business or financial records are incomplete, unreliable or non-existent;
- The accused deals primarily in cash; and
- Known sources of income do not support the accused lifestyle.

## Net Worth Analysis

What types of income can be determined through a net worth?

A Net Worth can be used to quantify income earned from both legitimate business operations as well illicit business operations. These could include, but are not limited to:

- Unreported business or personal income (Tax Evasion)
- Income earned from drug trafficking
- Income earned from bribery or corruption
- Income earned through theft or embezzlement
- Income earned through human smuggling or trafficking
- Income earned through extortion

## Net Worth Analysis

How does a net worth work?

A Net Worth looks at the change in assets and liabilities from one year to the next, adjusted for expenditures and known sources of funds to quantify the amount of illicit income.

The Net Worth always starts with a base year amount for assets and liabilities which is generally one day prior to the start of the investigation period.

For example, if your investigation period is from January 1, 2020 to December 31, 2023, a base year balance must be established for assets and liabilities at December 31, 2019.

# Net Worth Analysis

How to calculate illicit income using a net worth?

$$\begin{aligned} & \text{Asset} \\ & - \\ & \text{Liabilities} \\ & = \\ & \text{Net Worth} \\ & - \\ & \text{Prior Years Net Worth} \\ & = \\ & \text{Increase (Decrease) in Net Worth} \\ & + \\ & \text{Expenses and Adjustments} \\ & - \\ & \text{Known Sources of Funds and Adjustments} \\ & = \\ & \text{Total Illicit Income Earned} \end{aligned}$$

## Net Worth Analysis

Who gets included in a net worth analysis?

Who gets included in the Net Worth Analysis is determined on a case by case basis. In most situations the following people are included in the Net Worth Analysis:

- Accused
- Spouse
- Dependent Children

Depending on the case, the Net Worth Analysis could be expanded to include:

- Parents of the accused or spouse
- Adult children
- Other relatives or individuals residing with the accused

## Net Worth Analysis

What gets included in a net worth analysis?

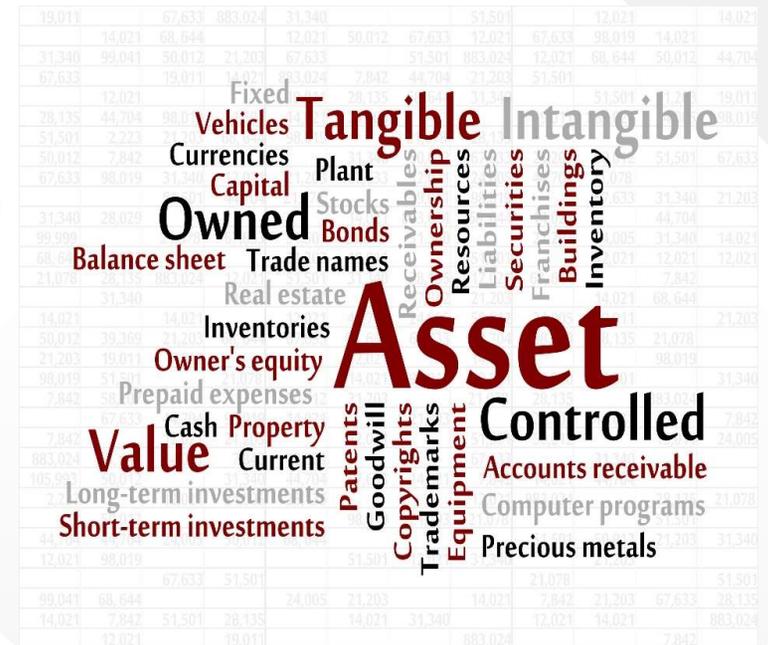
- Personal and business assets of the accused, spouse and dependent family members.
- Personal and business liabilities of the accused, spouse and dependent family members.
- Personal expenditures of the accused, spouse and dependent family members.
- Known sources of funds of the accused, spouse and dependent family members.

# Net Worth Analysis

## Assets

### Types of Assets for Discussion

- Bank Account Balances
- Personal Business Assets (Sole Proprietorship)
- Cash on Hand
- Investment Accounts
- Vehicles
- Real Property
- Accounts and Assets in Foreign Currency



# Net Worth Analysis

Bank account balances

## How Do I Obtain This Information?

- Bank statements obtained through the use of a search warrant or other judicial order

## What Amount Gets Recorded on the Net Worth?

- The balance in the account at December 31<sup>st</sup>.

# Net Worth Analysis

Personal business assets

## How Do I Obtain This Information?

- Personal Income Tax Returns
- Accounting records
- Regulatory filings
- Public databases

## What Amount Gets Recorded on the Net Worth?

- The cost of the asset. If the accused continues to own the asset throughout the investigation period, the cost of the asset recorded on the Net Worth remains the same.

# Net Worth Analysis

## Cash on hand

### How Do I Obtain This Information?

- Unfortunately cash on hand can not be factually determined but is often used by defense to explain a Net Worth discrepancy.

### What Amount Gets Recorded on the Net Worth?

- Since cash on hand cannot be factually determined, a number of steps can be taken to reasonably determine:
  - Was there cash on hand at the start of the investigation period?
  - How much cash was available?

# Net Worth Analysis

## Cash on hand

### Steps for Determining Cash on Hand:

- What was the amount of cash found during the execution of search warrants or during arrest?
- Was there interest paid on bank accounts, lines of credit and credit cards during the investigation period?
- Were any NSF cheques issued during the investigation period?
- Were any assets paid for in cash during the investigation period? Was the cash used to purchase the asset withdrawn from a bank account or is its origin unknown?
- Have there been any large cash deposits during the investigation period that could have an effect on the Net Worth?
- Was there an interview of the accused, co-accused or other family or friends? If yes, what was said regarding the quantity of cash held outside of the accused bank account at any given time?
- Review the income tax filings of the accused and their spouse prior to the start of the investigation period. Did the accused have the means to accumulate a large amount of cash during that period?

# Net Worth Analysis

## Cash on hand

- If it is determined that there was a reasonable possibility that the accused had cash on hand at the beginning of the investigation period, a determination should be made as to how much cash was available. This can be determined by looking at the following items:
  - The amount of cash used to purchase assets.
  - The amount of cash deposited into the accused bank and credit accounts that can not be attributed to a known source of income.
  - The amount of cash used to reduce outstanding liabilities.
- The benefit of the doubt should always be given to the accused when dealing with cash on hand since the amount used in the Net Worth can not be factually verified.



Remember, if the amount of cash on hand remains constant throughout the investigation period, there will be no impact on the Net Worth.

# Net Worth Analysis

## Investments

### How Do I Obtain This Information?

- Income Tax Returns.
- Investment Statements obtained through a search warrant or other judicial order.

### What Amount Gets Recorded on the Net Worth?

- For tax sheltered investments, the cumulative amount contributed to the investment at December 31<sup>st</sup> is used.
- For all other investments, the adjusted cost base of the investment at December 31<sup>st</sup> is used.

# Net Worth Analysis

## Vehicles

### How Do I Obtain This Information?

- Motor vehicle registry.
- Vehicle purchase receipts obtained through the use of a search warrant or other judicial order.
- Surveillance.
- Loan registries.

### What Amount Gets Recorded on the Net Worth?

- The purchase price of the vehicle gets recorded at December 31<sup>st</sup> in the year the vehicle is purchased.
- The purchase price of the vehicle remains on the Net Worth until the vehicle is sold or disposed of.

# Net Worth Analysis

## Real Property

### How Do I Obtain This Information?

- Land ownership registry.
- Property purchase documents obtained through the use of a search warrant or other judicial order.
- Surveillance.
- Witness interviews.
- Loan registries.

### What Amount Gets Recorded on the Net Worth?

- The purchase price of the property gets recorded at December 31<sup>st</sup> in the year the property is purchased.
- The purchase price of the property remains on the Net Worth until the property is sold

# New Worth Analysis

## Accounts and assets in a foreign currency

### How Do I Obtain This Information?

- Documents obtained through the use of a search warrant or other judicial order.
- Foreign Land Registry databases.
- Mutual Legal Assistance Treaty (MLAT).
- Treaty Requests for tax information.
- Non-treaty requests.

### What Amount Gets Recorded on the Net Worth?

- If the asset was real property, a vehicle or another asset that is purchased in very few specific transactions, the value should be recorded on the Net Worth in the year it is purchased and at the daily exchange rate used for the transaction. This amount would be carried forward on the Net Worth for each subsequent year the accused owns the asset.
- For bank account and credit card account balances, an annual exchange rate can be applied.
- Both the daily and annual exchange rate information can be obtained from your country's central banking authority.

# Case Study #1

- Taxpayer came to the attention of the CRA through an underground economy project that showed individuals who owned residences with high property taxes and reported low income.
- Family owned and operated a complex corporate structure which consisted of nine closely held family corporations
- Mother and father operated a fast-food outlet in a large shopping mall and their son operated a retail outlet and then later another fast-food outlet in a large shopping mall
- The family appeared to live a lifestyle beyond what could be supported by reported income in their income tax returns as per an audit that was conducted
- It was alleged the family members skimmed money from their cash businesses – it was believed the cash registers were often left open in order to allow the employees to sell without recording the transactions

## GROUP DISCUSSION

Please spend 20 minutes in your group and discuss what are some investigative steps you could take to determine if there was unreported income?

# Case Study #1

## The Investigation Revealed:

- Family operated businesses had no controls – same bookkeeper for all businesses
- Businesses were cash-based businesses
- Surveillance revealed the cash register was not closed between transactions
- Investigator ordered food and asked for a receipt; one was printed from the register
- Visited two experts on cash registers, learned the open cash drawer was irrelevant, sales could still be rung in with it open, however was told the cash register would make a sound if the transaction was recorded. Sales could be voided by pushing the clear key after the numbers were entered. This would make \$0.00 show up on the LCD screen.
- Sales reported by the business to the mall were the same as reported on the tax returns
- Made another purchase from the business and heard the cash register make no sound for the 10-12 people who were in line with the investigator. The LCD display showed as \$0.00.
- Based on all this obtained search warrants for 7 locations.
- During search, significant amounts of cash were found at the residences.
- Investigator completed a net worth using audit information and new financial information found during the execution of the search warrants.
- Investigators conducted two other calculations, one called a 'plate theory' and another using gross profit margin.
- Employees of the businesses were called to testify

## Case Study#1

- The net worth revealed unreported income for three years totalling \$700,000 for the parents and for four years totalling \$180,000 for the son
- Based on an average transaction of \$5.00, 48,000 transactions in a year would not have been reported at the parent's food outlet. That works out to 167 sales per day not reported.
- The plate theory revealed more plates were purchased than there were sales.
- Using \$5.00 a plate unreported income for three years totalling \$365,000 for the parents.
- Interviews with the staff revealed plates had been damaged, used by staff, and extras given out to customers

## Case Study #1

- Was cash suppressed from the cash register at the food outlets?
  - Court found the Crown's evidence inconclusive
- Were number of plates used an indication of income?
  - Plate theory found inconclusive
- Indirect Verification of Income technique accurate?
  - Court found there were errors in a net worth, specifically around the opening net worth causing an overstatement of assets and expenses

# Net Worth Analysis

## Liabilities

### Types of Liabilities for Discussion

- Value Added Taxes Payable (VAT)
- Credit Cards and Lines of Credit
- Personal Loans
- Mortgages



# Net Worth Analysis

## Value added taxes payable

### How Do I Obtain This Information?

- Government tax authority records.
- Business and accounting records.

### What Amount Gets Recorded on the Net Worth?

- The amount owing to government tax authority at December 31<sup>st</sup> is recorded on the Net Worth. The formula to calculate the balance is as follows:

December 31 Net VAT Owing (Base Year)  
+  
Net VAT Owing (Receivable) for Current Year  
-  
VAT Remitted (Refunded) for Current Year  
=  
VAT Owing (Current Year End)

# Net Worth Analysis

## Credit cards and lines of credit

### How Do I Obtain This Information?

- Credit card and line of credit statements obtained through the use of a search warrant or other judicial order.

### What Amount Gets Recorded on the Net Worth?

- The balance in the account at December 31<sup>st</sup>.

### Items to Remember

- The majority of credit cards do not have their statements issued on the last day of the month.
- The amount included on the Net Worth should be the December 31 balance which could fall in between statement dates.
- Reconcile the transactions on the credit card to December 31 based on their transaction date.

# Net Worth Analysis

## Personal loans

### How Do I Obtain This Information?

- Loan and/or banking documents obtained through the use of a search warrant or other judicial order.
- Witness interviews.
- Loan registries.

### What Amount Gets Recorded on the Net Worth?

- The balance owing in the account at December 31<sup>st</sup>

# Net Worth Analysis

## Mortgages

### How Do I Obtain This Information?

- Land ownership registry.
- Property purchase documents obtained through the use of a search warrant or other judicial order.
- Loan registries.

### What Amount Gets Recorded on the Net Worth?

- The balance owing on the mortgage at December 31<sup>st</sup>.

### Items to Remember

- Mortgage payments generally contain two components, the principal payment on the mortgage balance and interest on the mortgage balance. Each amount will be dealt with separately in the Net Worth.

# Net Worth Analysis

## Expenses and adjustments

What type of expenses and adjustments are included?

- Personal Expenses
  - Living Expenses
  - Household Expenses
  - Food
  - Travel
  - Clothing
  - Entertainment and Recreation
  - Healthcare
  - Interest on personal debt
- Adjustments
  - Amounts withheld from employment income
  - Loss on sale of assets
  - Other items specific to your country's laws and regulations



# Net Worth Analysis

Expenses and adjustments

## How Do I Obtain This Information?

- Transactions listed in bank and credit card statements
- Expense receipts obtained through the use of a search warrant
- Income Tax Returns
- Witness interviews
- Surveillance
- Land ownership registry
- Loan registries

## What Amount Gets Recorded on the Net Worth?

- The total expenses incurred by the accused and their household on an annual basis.

# Net Worth Analysis

Known sources of funds and adjustments

What Sources of funds and adjustments are included?

- Different types of income
  - Employment income
  - Net business income
  - Investment income
- Gifts from family or friends
- Insurance
- Payments from Government benefit programs
- Income Tax refunds
- Inheritance
- Lottery winnings
  
- Adjustments
  - Gain on sale of assets
  - Other items specific to your country's laws and regulations

# Net Worth Analysis

## Net worth presentation

- The Net Worth Analysis should be accompanied by a written report on your findings. The report would include items such as:
  - Information about the author
  - Scope of the work
  - Summary of findings
  - Background
  - Methodology
  - Detailed findings
  - Conclusion
  - Schedules and exhibits

# Net Worth Analysis

## Net worth presentation

- All amounts entered in the Net Worth should have a corresponding source document to reconcile the amount.
  - Where the source document is a large PDF, use bookmarks to help the reader find the corresponding information.
- Create an electronic folder for each Net Worth schedule (assets, liabilities, expenses and sources of funds) that will contain the source documents. This allows the referencing to stay consistent no matter where the Net Worth is moved to. This also allows for easier disclosure as all the documents pertaining to the Net Worth will be kept together.
- For a cleaner looking final product, remove any pre-populated item descriptions that were not used in your analysis.
- Assets such as bank accounts should remain as an asset regardless of whether they are in a debit or credit position.
- Liabilities such as credit cards and line of credit accounts should remain as a liability regardless of whether they are in a debit or credit position

## Case Study #2

- Husband and wife were the sole owners of an electrician business
- The corporation failed to keep proper books and records.
- The corporation had a bookkeeper.
- Business had previously been audited and reassessed and the husband had signed an undertaking to keep proper books and records.
- Husband and wife were living a lifestyle not supported by the amount of reported income.

### Group Discussion

Knowing what you know now about proving income, please spend 20 minutes in your group discussing what method would you use to calculate the husband and wife's income and what type of evidence you would try to collect?

## Case Study #2

Facts that came out of the investigation:

- Personal expenses were claimed as business expenses
  - Meals charged in certain locations where there was no work being conducted
  - Purchase of personal assets claimed as business expenses
  - Meals close to birthdays and anniversaries were claimed as business expenses
  - Shareholder meeting was held in the Caribbean
- Net worth was completed by the investigator showing an amount of unreported income

Facts that came out of court testimony:

- The investigator failed to interview any of the family members or the bookkeeper
- The investigator failed to search for any leads concerning alternative non-taxable sources of income
- Investigator made some arbitrary decisions as it related the evidence and how to treat it in the net worth
- Mistakes were made to how a scholarship was treated on the net worth

## Case Study #2

Statements made by the judge:

- Net worth assessment is by its nature an inexact process
- These estimates cannot hope to be precise and therefore need to be subject to rigorous scrutiny to determine if, in the end result, they are sufficiently conservative to the taxpayer's benefit.
- 'The technique of net worth assessment is subject to criticism as being inexact, at times arbitrary and subject to error';
- In circumstantial cases it is the total effect of the evidence that may or may not support the Crown's desired inference beyond a reasonable doubt. What may appear in isolation is not important, it is the cumulative effect of all the decisions made both in terms of the improper attribution of income and in terms of the overall reliability of the methods used; and
- A small portion of the items in the \$85,000 in claimed business expenses that were disallowed could have possibly been legitimate expenses. There was no evidentiary basis for concluding beyond a reasonable doubt that each one viewed on their own was a personal expense, however there was no contrary evidence to suggest they were legitimate business expenses.

## Case Study #2

- Decision:
  - Two aspects to the analysis that have to be considered:
    - Attitude of the investigator – displayed a complete detachment from the end results and appears objective as one could hope. Was fully qualified even though had limited experience in criminal matters;
    - Was a conservative approach taken – while some decisions could be subject for debate the overall effect is to substantially underestimate the net worth discrepancy and this was done; and
  - Contextual approach of the failure to interview the household or others does not undermine the prosecution

## Cash Method

- Cash based business
- Expected significant cash expenditures
- Subject has limited sources of income
- Deposits the cash income in a bank account
- Not relying on subject's records
- Circumstantial evidence

# Cash Method

## Formula

### All Cash Uses

- Personal expenditures paid in cash
- Increase in assets paid in cash
- Decrease in liabilities paid in cash

### Less: Known Cash Sources

- Non-taxable sources received in cash
- Decrease in assets
- Increase in Liabilities

### Less: Reported Net Income

### Equal: Unreported Income

# Questions?

