The Certified General Accountants Association of Canada's
Pre-Budget Submission to the House of Commons Standing Committee on Finance

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Executive summary

While the Government of Canada has been making a determined effort to bring tax rates down in recent years, Canada's income tax system has grown in volumes and become increasingly complex. Businesses and individuals are subjected to hundreds of various taxes from all levels of government – taxes that are unnecessarily complicated and difficult to understand, even duplicative or contradictory from one jurisdiction to another, and often making compliance cumbersome and labour-intensive.

On an international scale, Canada's tax system is among the most complicated in the world – this hurts our economy and adversely affects small and medium size enterprises (SMEs) as well as individual taxpayers.

Faced with a tight fiscal situation and the requisite to control public expenditures, the federal government will need to look for efficiencies and revenue-neutral or low-cost initiatives as it manages its top priority – the economy. Taking concrete steps to address tax measures or policies that unnecessarily add complexity to the tax system is an obvious solution.

The benefits of tax simplification are clear. A simple tax system increases transparency and reduces uncertainty and the likelihood of aggressive tax planning. It means higher compliance rates and lower compliance costs for taxpayers. It means less paperwork for business and lower administrative costs for government. It means a stronger system with a more secure tax base and predictable revenue.

Tax simplification is good for taxpayers, businesses and government – as well as Canada's economy. In fact, a simple, transparent and fair tax system with low, internationally competitive tax rates encourages investment and job growth – both of which are integral to the wellbeing and sustained revival of the Canadian economy.

Some of Canada's trading partners – including Australia, the United Kingdom and the United States – are realizing that inefficient tax systems reduce their competitiveness, and they are now taking steps to strengthen and streamline their tax regimes.

Canada – with all its fiscal advantages – cannot afford to fall behind its global neighbours and risk becoming a less attractive place to do business. To help build a strong, competitive 21st century economy, we believe the federal government should set a clear course to streamline and modernize Canada's tax regime.

Therefore, CGA-Canada recommends that the Government of Canada take immediate steps to simplify Canada's tax legislation and tax regime.

Introduction

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to once again participate in this important public consultation process in advance of the 2012 federal budget. We are pleased to share our comments and recommendations, and we look forward to appearing before the House of Commons Standing Committee on Finance in the fall of 2011.

Founded in 1908, CGA-Canada serves 75,000 Certified General Accountants and students in Canada and more than 90 countries. Respected accounting and financial management professionals, CGAs work in industry, finance, government and public practice. CGA-Canada establishes the designation's certification requirements and professional standards, offers professional development, conducts research and advocacy, and represents CGAs nationally and internationally.

The House of Commons Standing Committee on Finance has invited Canadians to submit up to three recommendations that focus on federal tax or program spending priorities. With this in mind, and in view of CGA-Canada's ongoing interest in Canada's taxation policy, we submit the following recommendation – specifically,

That the Government of Canada take immediate steps to simplify Canada's tax legislation and tax regime.

According to Benjamin Franklin, taxation is an absolute certainty. To this day, taxation continues to be an inescapable – and significant – fact of life in our modern global world. A study released by the Fraser Institute in April 2011 found that the average Canadian family spent more than 41 per cent of its annual income on taxes in 2010 – more than it paid for food, clothing and shelter combined. More specifically, the tax bill for a family with an average income has increased by an astounding 1,686 per cent since 1961 – to the point that taxes are now the largest expenditure facing a family today, outweighing the cost of basic necessities – which was not always the case.[i] Indeed, taxes matter.

The following brief to the House of Commons Standing Committee on Finance is intended to build upon and complement CGA-Canada's work in the area of tax simplification, including its most recently published *Issue in Focus – The Need for Tax Simplification – A Challenge and an Opportunity*, which highlights some of the central issues surrounding Canada's tax system as well as the need for tax simplification.[ii]

The issue

While the Government of Canada has been making a concerted effort to bring tax rates down in recent years, Canada's income tax system has grown in volumes and become increasingly complex. Businesses and individuals are subjected to hundreds of various taxes from all levels of government – taxes that are unnecessarily complicated and difficult to understand, even duplicative or contradictory from one jurisdiction to another, and often making compliance cumbersome and labour-intensive. At the other end of the spectrum, taxpayers are also eligible for certain targeted tax relief measures – such as exemptions, deductions, deferrals and credits – which are described as "tax expenditures" by Finance Canada and have multiplied many-fold in the past few years, adding further complexity to Canada's elaborate and intricate tax regime.

As identified in the interim report of the *Review of tax reliefs*, released by the Office of Tax Simplification in the United Kingdom in December 2010, tax complexity has many dimensions.[iii] It can be a case of simple language, or in this case the lack there-of, or the drafting style or way the tax code is ordered or arranged which makes it difficult for the average taxpayer to follow and understand. It can also relate to the underlying rules themselves, or the diversity of the tax system, that is the number and range of taxes, or even the frequency at which the rules change. Moreover, even with the simplest tax rule, complexity can arise in its implementation.

In *The Report on Tax Reform Options*, conducted by President Obama's Economic Recovery Advisory Board and published in August 2010, two additional factors are flagged as being big contributors to tax complexity. First, new provisions have been added to achieve a particular policy goal, but with insufficient attention being paid to how they interact with existing provisions – resulting in duplicative and overlapping provisions, multiple definitions of concepts, different phase-outs and expiration dates. Second, somewhat like Canada, the tax code has become more complex because legislators have increasingly used targeted tax provisions to achieve social policy objectives normally achieved by spending programs.[iv]

Moreover, complexity arises from the simple fact that the tax system serves a number of conflicting purposes. First, the tax system must respond to changing financial and economic circumstances. Second, the tax system should ensure fairness for taxpayers. Third, the tax system should provide taxpayers with a reasonable degree of certainty. Finally, and perhaps most importantly, the tax system should preserve revenue for the government.

From the viewpoint of the Auditor General of Canada, complexity appears to be synonymous with the lack of clarity, predictability and certainty inherent in Canada's *Income Tax Act* (ITA). In the Fall 2009 Report of the Auditor General, attention was drawn to the backlog of more than 400 technical changes needed to the *Income Tax Act* – proposed draft changes announced by the government but not yet enacted by Parliament. The vast majority of these amendments remain outstanding and, in the interim, taxpayers, professional accountants and even the Canada Revenue Agency (CRA) prepare for this new government policy and maintain records and forms for compliance purposes, not knowing if or when these legislative amendments will pass. Canada's Auditor General concluded that the *Income Tax Act* is one of the longest and most complex pieces of federal legislation.[v]

In a national poll concerning Canadians' views on tax simplification, commissioned by CGA-Canada and conducted by Nanos Research in June 2011, only one in ten Canadians involved in preparing or reviewing tax returns for a business thought the tax system for businesses is less complex than it was ten years ago. In addition, only one in seven respondents said that the personal income tax system is less complex than it was 10 years ago.

Now is the time

There is no better time than present to modernize Canada's tax regime.

For the average taxpayer, Canada's tax legislation – which includes a multitude of targeted tax measures – can be challenging to understand and impose unforeseen costs in terms of time, effort and money. Determining which credits or deductions apply to a particular situation, or how much money is owed to the Government of Canada, is not always straightforward – and often requires the services of professional accountants and lawyers. In that same Nanos Research survey, seven out of ten Canadians reported they do not complete their own personal income tax returns. In an April 2010 study, the Fraser Institute pegged the costs of preparing and filing personal income tax returns between $4 billion to $5.8 billion annually.[vi]

Even for tax practitioners and other professionals, there is a strong belief that filing requirements are unnecessarily complicated and that decisions and interpretations are difficult to obtain on a timely basis. In a national online survey conducted with CGAs in July and August 2010, they overwhelmingly agreed that tax simplification as well as fair and equitable tax administration were their uppermost concerns.

For the SME sector, Canada's tax system is inefficient, full of red tape, laborious and costly. Businesses in Canada pay a whopping $12.6 billion a year to meet their compliance requirements – in addition to their taxes remitted – according to the Canadian Federation of Independent Business.[vii] In addition to the costs associated with this compliance burden, businesses often pay an even greater price in terms of lost opportunities – time and money that could be better spent on much more productive endeavours instead of determining how much tax to pay. It is important to note that the issues faced by the SME sector in relation to tax complexity – such as the compliance burden – also affect the not-for profit sector, including charities.

For the government, the system is costly to administer and maintain. Faced with a tight fiscal situation and the requisite to control public expenditures, the federal government will need to look for efficiencies and revenue-neutral or low-cost initiatives as it manages its top priority – the economy. Taking concrete steps to address tax measures or policies that unnecessarily add complexity to the tax system is an obvious solution.

The benefits of tax simplification are clear. A simple tax system increases transparency and reduces uncertainty and the likelihood of aggressive tax planning. It means higher compliance rates and lower compliance costs for taxpayers. It means less paperwork for business and lower administrative costs for government. It means a stronger system with a more secure tax base and predictable revenue.

Tax simplification is good for taxpayers, businesses and government – as well as Canada's economy. In fact, a simple, transparent and fair tax system with low, internationally competitive tax rates encourages investment and job growth – both of which are integral to the wellbeing and sustained revival of the Canadian economy.

International context

Some of Canada's trading partners – including Australia, the United Kingdom and the United States – are realizing that inefficient tax systems reduce competitiveness, and they are taking steps to strengthen and streamline their tax regimes.

The Government of Australia launched an independent review process in 2008 (the "Henry Tax Review") to help position Australia to address 21st century challenges and – in the process – provide a framework to make the tax system simpler, fairer and more efficient for Australian working families and businesses. The two-year review brought forward 138 recommendations and in May 2010 the Australian government announced its preliminary response to the report and the "first wave" of its reform agenda. The government has committed to implementing these measures over the next 10 years, which are primarily related to company and small business taxes, superannuation, infrastructure and resources. A full second term agenda will follow and will focus on making tax time simpler, improving savings incentives, and strengthening the governance and transparency of the tax system.[viii]

In the United Kingdom, the Office of Tax Simplification (OTS) was launched in July 2010 to provide the government with independent advice on simplifying the UK tax system. The OTS was mandated to undertake two reviews – first, a review of all tax reliefs to provide recommendations as to whether a relief should be retained in its current state, simplified to ease administrative burdens, or be abolished altogether; and second, a review of small business taxation to provide advice on how to simplify the tax system, ease administration and reduce uncertainty for small business. In its review and consultation on tax reliefs[ix], the OTS examined 155 different reliefs – including ones relating to Income Tax, Capital Gains Tax and Inheritance Tax – and measured these against a consistent set of criteria to evaluate their effectiveness and relevance, such as evidence of a continuing policy rationale, taxpayer take-up and awareness, and the likely impact of changing or repealing the relief or exemption. In its final report, the OTS found that eight reliefs had expired and should be removed from legislation, and recommended 45 reliefs be abolished, 17 reliefs be simplified and 54 reliefs be retained.[x] The British government announced in its 2011 budget that it will abolish the 43 tax measures whose rationale was no longer valid – which will result in less complexity and over 100 fewer pages of tax legislation.[xi] With the interim report of the review of small business taxation in hand, and a final report pending, the British government has also publicly declared its intention to follow up on other specific recommendations advanced by the OTS to help achieve a simpler tax system.

In the United States, President Barack Obama – who made tax overhaul part of his platform during the 2008 presidential election campaign – appointed former Federal Reserve Chairman Paul Volcker to lead the President's Economic Recovery Advisory Board (PERAB), with a mandate to provide ideas and options to achieve tax simplification, greater tax compliance and corporate tax reform. In August 2010, the PERAB came forward with a 118-page report on potential tax reform options, documenting the advantages and disadvantages to a wide range of proposals – including simplification options for family benefits, savings and retirement incentives, capital gains, tax filing, small businesses and the Alternative Minimum Tax (AMT)[xii]. In his State of the Union address to Congress in January 2011, President Obama demonstrated his full support for tax reform and his willingness to work with Democratic and Republican members when he said "the best thing we could do on taxes for all Americans is to simplify the individual tax code"[xiii]. As acknowledged, this will not be an easy job, and will require political leadership, vision and resolve, especially in view of the U.S. debt crisis and fragile economy.

Canada – with all its fiscal advantages – cannot afford to fall behind its global neighbours and risk becoming a less attractive place to do business. We believe the federal government should look at how Canada's tax regime could be streamlined and modernized to help build a strong, competitive 21st century economy.

Next steps

CGA-Canada recommends that the Government of Canada take immediate steps to simplify Canada's tax legislation and tax regime by:

Tackling the backlog of hundreds of unlegislated tax proposals. For various reasons, the last income tax technical bill passed by Parliament was over 10 years ago. Now that the government has consulted extensively over the last year on a series of draft legislative proposals, it should introduce a technical tax bill before Parliament this fall.

Implementing a "sunset provision" for unlegislated tax proposals. CGA-Canada believes this approach is the most effective way to address unlegislated tax proposals. With this policy, if a tax change is announced and not incorporated into legislation within a reasonable amount of time, the measure would be deemed to have lapsed – as is the case in Britain. This would bring greater clarity, certainty and predictability to tax legislation, reduce the compliance and paperwork burden, and deal with the ever-present backlog of unlegislated tax proposals.

Avoiding the introduction of any further targeted tax relief measures. Targeted taxes have been criticized by some as being economically inefficient, unfair by singling out one specific group or activity for preferential treatment, costly in terms of administrative and compliance requirements, and more complicated – compared to broad-based tax reductions. In the June 2011 Nanos Research national poll regarding Canadians' views on tax simplification, a majority of Canadians (seven out of ten) said they preferred having a lower overall tax rate as opposed to the government preserving special tax credits. Moreover, one of the main messages emanating from the U.K. OTS review of tax reliefs was "in the interests of fairness, tax reliefs should be avoided where these satisfy special interest groups or industry sectors".[xiv] CGA-Canada agrees with this finding and submits that the federal government should go even further by reviewing and evaluating the effectiveness of existing targeted tax measures and other revenue sources such as licensing fees and levies, borrowing some of the methodology from the U.K. experience.

Keeping tax rates low. Personal income tax rates and thresholds have been adjusted in recent years, and the general corporate income tax rate will fall to 15 per cent by 2012. Low tax rates facilitate compliance. In effect, low tax rates lessen the possibility of aggressive tax planning, as well as the likelihood of further and even more complicated legislative measures to close loopholes.

Strengthening enforcement efforts on existing tax rules instead of adding new rules and regulations. One of the ideas put forward by the U.S. PERAB in its *Report on Tax Reform Options* was that of dedicating more resources to enforcement and enhancing enforcement tools to reduce the tax gap – which is defined as the difference between the amount of taxpayers' tax obligations for a given year and the amount that is actually paid on time.[xv] Although compliance statistics for Canada's federal tax system appear difficult to locate, an OECD study examining a number of member countries noted that in Canada, individual taxpayers paid their taxes in a timely manner more than 90 per cent of the time between 2002-03 and 2006-07, taxable corporations ranged from 93.1 per cent falling to 85.4 per cent over that period, and the rate of employers varied from 90.4 per cent to 87.7 per cent over that same time frame.[xvi] While it is clearly apparent that the vast majority of taxes are paid on time, these uncollected taxes add up significantly. According to the Auditor General of Canada, at the end of March 2005, the undisputed and growing tax debt totaled over $18 billion, including penalties and interest.[xvii] Were the CRA to strengthen its enforcement efforts – through additional training and resources – to collect the taxes owed, it is likely that these potential extra costs could be offset by the additional revenue derived from its improved detection capabilities.

Expanding on harmonization efforts. The federal government should continue to work with the three "hold-out" provinces (Saskatchewan, Manitoba and Prince Edward Island) to help facilitate the transition to provincial value-added sales taxes harmonized with the GST. Under a Harmonized Sales Tax (HST), consumers and businesses deal with only one tax rate, one tax base, one set of rules and one administrative body instead of two of each. It follows that all the benefits associated with a simplified tax system would apply to a single sales tax system. Furthermore, sales tax harmonization on a national scale would give Canada the strong tax advantage it seeks in all provinces – helping to improve business competitiveness, attract new investment, and increase Canada's productivity.

Increasing parliamentary scrutiny on federal tax expenditures. A list of "ten tenets for a better tax system", compiled by the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW), purports that "tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament".[xviii] Given that federal tax expenditures in Canada exceeded $100 billion in 2009, CGA-Canada would support the Parliamentary Budget Officer's suggestion to "consider establishing a process of review for existing tax expenditures similar to that provided for all other public expenditures."[xix] With increased scrutiny from parliamentarians, it is hoped that these tax measures would be exposed to more rigorous review and evaluation to ensure they meet certain established principles – such as simplicity, transparency, certainty, efficiency, fairness and whether they serve a valid policy rationale.

Seeking advice from subject matter experts. One aspect that Australia, the United Kingdom and the United States share in common is their reliance on independent experts to conduct a review of the tax system, consult widely, and provide third party advice to legislators and policy-makers. Canada is well poised to learn from the experiences of its global counterparts. CGA-Canada also believes that the House of Commons Standing Committee on Finance has an instrumental role to play in this process, as it could assist in drafting the Terms of Reference, framing the issues and defining the scope of study for an expert panel that has been mandated to review Canada's tax legislation and tax regime.

Concluding remarks

CGA-Canada thanks members of the House of Commons Standing Committee on Finance for the opportunity to provide its views and recommendations on how Canada's tax regime could be simplified and modernized to help build a strong, competitive 21st century economy. We remain available for further comment or questions, and wish you well in your deliberations.

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