

Minister
of National Revenue



Ministre
du Revenu national

Ottawa, Canada K1A 0A6

FEB 22 2017

The Honourable Wayne Easter, P.C., M.P.
Chair of the House of Commons Standing Committee on Finance
House of Commons
Ottawa ON K1A 0A6

Dear Colleague:

Pursuant to Standing Order 109 of the House of Commons, I am pleased to respond on behalf of the Government of Canada to the recommendations made in the Sixth Report of the Standing Committee on Finance entitled: *The Canada Revenue Agency, Tax Avoidance and Tax Evasion: Recommended Actions*, tabled in the House of Commons on October 26, 2016.

The Government would like to thank the Committee for its detailed study of the Canada Revenue Agency's efforts to combat tax avoidance and evasion. The Government appreciates both hearing and reading the insights provided by the diverse and distinguished series of witnesses who offered their testimony before the Committee.

The Government Response takes into account the Canada Revenue Agency's mission, which is to administer tax, benefits, and related programs, and to ensure compliance on behalf of governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians. It also supports my mandate letter priority to crack down on tax evaders and work with international partners to adopt strategies to combat tax avoidance.

Please find enclosed a copy of the Government's Response to the recommendations of the Report.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Diane Lebouthillier'.

The Honourable Diane Lebouthillier, P.C., M.P.
Minister of National Revenue

Canada The word 'Canada' in a bold, serif font, with a small Canadian flag icon to the right of the 'a'.

**GOVERNMENT RESPONSE TO THE SIXTH REPORT OF THE STANDING
COMMITTEE ON FINANCE ENTITLED: *THE CANADA REVENUE AGENCY, TAX
AVOIDANCE AND TAX EVASION: RECOMMENDED ACTIONS***

INTRODUCTION

The Government of Canada is pleased to respond to the Sixth Report of the Standing Committee on Finance entitled: *The Canada Revenue Agency, Tax Avoidance and Tax Evasion: Recommended Actions*, tabled in the House of Commons on October 26, 2016. After carefully reviewing the Committee's report, the Government has chosen to respond to each recommendation individually.

The Government of Canada appreciates the work of the Committee and welcomes its analysis, views and recommendations, which are based on consultations with stakeholders and experts in the field of tax avoidance and tax evasion. The Government shares the Committee's commitment to better understand tax avoidance and tax evasion in order to combat it effectively.

CANADA'S FIGHT AGAINST TAX AVOIDANCE AND EVASION

Canada operates a self-assessment tax regime whereby taxpayers calculate their own taxable income, including domestic and foreign income, and pay taxes owing on it. Tax evasion and aggressive tax avoidance schemes rob Canadians of important resources, and deprive all levels of government of tax revenues that provide essential services to all Canadians.

"Tax avoidance" is defined as any taxpayer activity that minimizes tax payable by contravening the object and spirit – but not the letter – of the law. Tax avoidance can include "aggressive tax planning", which refers to domestic and international strategies that push the limits of acceptable tax planning. Aggressive tax planning involves a transaction or a series of transactions undertaken primarily to obtain a tax benefit, not for a genuine business purpose.

"Tax evasion" involves the deliberate underreporting of tax payable by concealing income or assets, or by making false statements. Tax evasion violates the object, spirit and letter of the law.

The Government of Canada is strongly committed to cracking down on tax evasion and aggressive tax avoidance to ensure a tax system that is responsive and fair for all Canadians. In Budget 2016, the Government of Canada invested an unprecedented \$444.4 million over five years to enhance the Canada Revenue Agency's (CRA's) ability to detect and audit aggressive tax avoidance, and to prosecute tax evasion – both at home and abroad.

The CRA is taking concrete actions to ensure that taxpayers are not burdened unfairly by a minority who choose not to pay what they owe, by avoiding or evading their tax obligations. The CRA is enhancing its business intelligence tools, hiring more tax experts to conduct more audits, enhancing its technical capacity, and improving the quality of investigative work that targets criminal tax evaders.

The Government of Canada has a robust system in place to tackle tax evasion and aggressive tax avoidance on many fronts, both domestically and internationally. These programs include advance tax rulings, legal requirements that provide the ability to obtain information on certain taxpayers from third parties, specific and general anti-avoidance rules and a progressive system of penalties. Other tools and programs include: identifying high-value money transfers as they cross borders to and from Canada, identifying international non-compliance and abuses through the exchange of information within a large treaty network, combatting avoidance by big multinational enterprises through actions set in the Organisation for Economic Co-operation and Development (OECD) and the Group of Twenty (G20), in relation to their Base Erosion and Profit Shifting (BEPS) Project, and a Criminal Investigations Program that investigates suspected cases of tax evasion, fraud, and other serious violations of tax laws and recommends cases to the Public Prosecution Services of Canada for criminal prosecution.

The CRA continues to introduce new tools and techniques against tax avoidance and tax evasion. These efforts have generated positive results. In 2015-2016, CRA auditors conducted over 120,000 audits that resulted in more than \$12 billion in additional taxes assessed, as well as penalties and interest. About two-thirds of this amount came from audits relating to international and large businesses, and high net-worth individuals.

The Government Response demonstrates the Government's commitment to crack down on aggressive tax avoidance and tax evasion.

RECOMMENDATIONS

Recommendation 1: The Minister of National Revenue conduct a comprehensive review of the advance tax ruling process. As part of that review, the Minister should identify ways in which efficiency and timeliness could be improved, costs could be reduced and effectiveness could be increased. This review should be completed by 31 March 2017.

The Government of Canada supports this recommendation. The CRA understands that tax certainty is important and that advance income tax rulings promote voluntary compliance. The Government of Canada is also committed to the global effort to address BEPS, led by the G20 and the OECD. Under the BEPS initiative, the CRA will exchange information on advance income tax rulings with other tax administrations to help ensure early awareness of tax planning that impacts the relevant countries. Canada made its first exchanges in December 2016.

The CRA will conduct a review of its advance tax ruling process by March 31, 2017. The review will include engaging relevant external stakeholders to obtain feedback on the timeliness and effectiveness of the process and to identify possible improvements. The review will also consider the effectiveness of the Pre-ruling Consultation service, which has been in place since 2013. This service provides an opportunity for taxpayers to discuss a transaction prior to submitting a formal ruling request. Its goal is to make the process more timely and efficient by providing taxpayers with an early indication of the CRA position prior to submitting a formal request and to ensure that all relevant information is then submitted.

Recommendation 2: The Minister of National Revenue require tax advisors operating in Canada to register all of their tax products with the Canada Revenue Agency.

The Government of Canada supports this recommendation. The disclosure of higher risk transactions is a cornerstone of self-reporting tax regimes. The OECD/G20 BEPS Project also recently issued guidelines for mandatory disclosure rules, under Action 12. The OECD guidelines encompass specific reporting requirements for international transactions and expedited filing of reports, in order to facilitate early identification of tax avoidance schemes, and increased penalties for non-compliance.

Canada's existing mandatory disclosure legislation defines hallmarks of reportable tax products. For example, existing legislation requires that promoters of tax shelters obtain a tax shelter identification number before marketing the tax shelter. In addition to the tax shelter registration legislation, other income tax legislation (referred to as the "reportable transactions" rules) requires promoters and advisors to report transactions meeting predetermined criteria on potential abusive tax avoidance to the Government of Canada. Each report received is reviewed for possible audit action.

The review of existing reportable transactions legislation is led by the Department of Finance, with support of the CRA. The Government will consider whether changes to the current regime are required in order to ensure that high-risk transactions are disclosed. The Government will review and update Canadians on the outcomes.

Recommendation 3: The Canada Revenue Agency conduct a comprehensive review of its Voluntary Disclosures Program. As well, it should review the guidelines that are used to determine whether to pursue litigation or to seek a settlement with individuals or organizations that have engaged in tax avoidance or tax evasion. These reviews should be completed by 31 March 2017.

The Government of Canada supports this recommendation. Both voluntary disclosures and audit settlements require expertise to balance competing objectives, such as fairness, legal risk, revenue maximization, and deterrence.

Voluntary Disclosures Program

The CRA will complete a review of the Voluntary Disclosures Program (VDP) by March 31, 2017. Further to the spring 2016 Committee hearings, the Minister of National Revenue sought input from the Offshore Compliance Advisory Committee (OCAC), an independent expert advisory committee providing her and the CRA with recommendations to combat offshore tax evasion and aggressive tax planning, including on the VDP. The OCAC provided its first report to the Minister on December 5, 2016, on the subject of the CRA's VDP. The Minister and the CRA will leverage OCAC's recommendations as part of the review. It is expected that the review will result in some changes to tighten the criteria for acceptance into the program, which is consistent with the CRA's strategic direction. The CRA will also share any proposed changes to the VDP with Canadians for input after completing the review, given the importance of this issue.

Audit Settlements

The CRA strives for effective and efficient resolution of audit files; the CRA only settles audit files on a principled basis in accordance with legislation that we administer (*Income Tax Act*, *Excise Tax Act* and other fiscal legislation).

As it is equally important for the CRA to be transparent about the process of negotiated audit settlements, the CRA will review its guidelines by March 31, 2017. With regards to tax evasion cases, these criminal matters are handled by the Public Prosecution Service of Canada.

Recommendation 4: The Minister of National Revenue strengthen protections for individuals under the Informant Leads Program and the Offshore Tax Informant Program. As well, the Minister should ensure that these programs are properly incentivized and that all credible information that is obtained through them is properly investigated.

The Government of Canada supports this recommendation. The CRA appreciates the importance of leads from the public and the need to protect informants, in relation to either the Informant Leads Program or the Offshore Tax Informant Program.

The Government of Canada through the CRA will review these two key programs, with a view to modernize intake and interaction with information. The Informant Leads Program has remained unchanged for many years and is due for modernization; multi-departmental interest exists to pursue formal and blanket protection to the identity of informants. In addition, the CRA will promote benefits and incentives of these programs to encourage informants to come forward.

Recommendation 5: The Minister of National Revenue report to the House of Commons Standing Committee on Finance regarding the progress of audits in relation to the “Panama papers.” The report should be made before 1 June 2017.

The Government of Canada supports this recommendation. The CRA had received information from a number of sources prior to the International Consortium of Investigative Journalist’s coverage of the Panama Papers. Through active international collaboration and domestic sources, the CRA has gathered additional information during 2016, including from Canadian banks. The CRA has analyzed over 11.5 million documents leaked through the media related to the Panama Papers and identified over 2,600 records with a link to Canada. There are 85 taxpayers identified for further review; 60 of these taxpayers are under audit.

The CRA continues to collaborate with other jurisdictions and is leading the detailed work on mapping the structure of the tax schemes. While the complexity of the audits make it unlikely that any will be fully resolved by June 1, 2017, the CRA will report on its approach, results to date and other project findings.

Recommendation 6: The Canada Revenue Agency enhance its technical, human resource and other capabilities in respect of –and knowledge about – domestic and international aggressive tax planning.

The Government of Canada supports this recommendation. There is currently an increasing technical sophistication to tax schemes, and a greater use of legal challenges to delay and/or oppose CRA efforts to audit taxpayers. The CRA is committed to enhancing its intelligence and technical capacities for the early detection of promoters of tax avoidance schemes.

The CRA will continue to broaden the skillset in its compliance programs by increasing the number of employees with legal, economical and statistics training, and by recruiting externally for both recent graduates and mid-career professionals. In addition, the CRA will continue to contribute and also learn from OECD-led collaboration on tax matters, where it currently sponsors the OECD’s Forum on Tax Administration Large Business and International Program.

With the funding received in Budget 2016, the CRA will develop additional tools to leverage all sources of domestic and offshore business intelligence, hire new resources to support compliance efforts and expand the coverage of high-risk taxpayers and promoters.

Recommendation 7: The Minister of National Revenue ensure that the Canada Revenue Agency calculate Canada's federal tax gap on an ongoing basis. As well, the Agency should make information about the size of that gap, and the methodology used to calculate it, publicly available.

The Government of Canada supports this recommendation. On April 11, 2016, the Minister of National Revenue committed to begin work on estimating the tax gap, with the objective of understanding the benefits and drawbacks of tax gap estimation to maximize the value of this tool in the Canadian context.

As a first step in delivering on the Government's commitment, on June 30, 2016, the Government published two studies: a conceptual study on the tax gap and an estimate of the GST/HST gap. In the conceptual study, the Government of Canada committed to publishing a series of additional papers on various components of the tax gap over the next two to three years. Some of the papers will contain estimates of particular components of the tax gap, while others will be more theoretical in nature.

When providing tax gap estimates, the Government will make its methodology available to the public. It is anticipated that the next paper, on personal income tax compliance, will be published in the spring of 2017.

Recommendation 8: The federal government, in an effort to reduce complexity and any inequities that distort behaviour and can lead to tax avoidance or tax evasion, accelerate its review of the Income Tax Act and expeditiously implement initiatives aimed at simplifying the income tax system. This review should be completed by 30 June 2017. The House of Commons Standing Committee on Finance should study those initiatives and any resulting proposed legislative amendments as part of its planned review of the Act.

The Government of Canada supports this recommendation. In recognition of concerns that have been expressed regarding the efficiency, fairness and complexity of the tax system, the Government of Canada announced, in Budget 2016, the undertaking of a comprehensive review of federal tax expenditures over the coming year. The objective of the review is to ensure that federal tax expenditures are fair for Canadians, efficient and fiscally responsible. This review is part of a broader Government commitment to eliminate poorly targeted and inefficient programs, wasteful spending, and ineffective and obsolete Government initiatives.

The review of federal tax expenditures is led by the Department of Finance, with the support of a group of external experts. The Government will update Canadians on the outcomes from the review through Budget 2017.

Recommendation 9: The federal government take steps to improve coordination between the Canada Revenue Agency, which investigates situations of possible tax evasion, and the Department of Justice, which prosecutes cases of tax evasion.

The Government of Canada supports this recommendation. The Public Prosecution Service of Canada (PPSC), not the Department of Justice (JUS), is responsible for the prosecution of tax evasion. A close relationship between the CRA, JUS and PPSC ensures that cases investigated and referred for prosecution are of the highest quality. The CRA will review the current Memorandum of Understanding between the CRA and PPSC and update it as appropriate to enhance cooperation and engage on ways to advance cases.

With the Budget 2016 investment, the CRA will increase cooperation with JUS and PPSC. The CRA will seek the assistance of dedicated JUS lawyers on various regulatory, legislative, and policy issues throughout the criminal investigations stage of cases of alleged tax evasion.

Recommendation 10: The Minister of National Revenue, by 31 August 2017, establish a regular reporting program for the Canada Revenue Agency that would facilitate the public availability of statistical information about enforcement efforts in relation to tax evasion and tax avoidance schemes. The reporting program should identify the number of investigations leading to convictions or settlements, and associated penalties and interest rates, as well as enforcement efforts in relation to high-risk individuals and corporations.

The Government of Canada supports this recommendation. The Government acknowledges that Canadians should be aware of the efforts made by the Government to ensure everyone pays their fair share. The CRA will review its departmental performance reporting and will enhance it with statistical information in relation to enforcement efforts on tax evasion and tax avoidance schemes by August 31, 2017.

At a minimum, reporting related to tax evasion will include the number of: referrals to criminal investigations, searches, files where charges are laid, convictions, and the associated Court imposed fines and/or jail sentences. As for tax avoidance schemes, reporting will include the number of audits, fiscal impact, referrals to the General Anti-Avoidance-Rule (GAAR) Committee, applications of the GAAR and third-party civil penalties. To complement this annual publicly available reporting, the CRA will continue to seek opportunities to report results via the media and the CRA website.

Recommendation 11: The federal government review the 92 tax treaties and 22 tax information exchange agreements to which Canada is a party in order to ensure that they do not facilitate non-compliance with tax laws, particularly with respect to the secrecy associated with certain jurisdictions and their banking practices. This review should be completed by 31 August 2017.

The Government of Canada supports this recommendation. Exchange of information provisions in tax treaties and tax information exchange agreements (TIEAs) enable the CRA to request information relevant to Canada's domestic tax laws within the possession of, or accessible by, the tax authorities of another jurisdiction, in order to better enforce and administer Canada's taxation laws, and to prevent international tax evasion.

Since 2007, Canada has insisted that all new tax treaties and TIEAs, including revisions to existing tax treaties, include the international standard for exchange of information on request. This standard ensures that bank secrecy and the lack of a domestic tax interest cannot be used as reasons to deny exchanging information.

The Global Forum on Transparency and Exchange of Information for Tax Purposes, of which Canada and over 120 other jurisdictions are members, is currently engaged in the review of exchange of information provisions to ensure that they comply with the international standard for exchange of information on request.

The Government will review the small number of Canada's exchange of information relationships (tax treaties, TIEAs and the Convention on Mutual Administrative Assistance in Tax Matters) that do not fall within the scope of the Global Forum's review to ensure that bank secrecy and the lack of a domestic tax interest cannot be used as reasons to deny exchanging information. The objective of the review will be to identify any exchange relationships that do not meet the international standard for the exchange of information on request.

The review of Canada's tax treaties and tax information exchange agreements will be led by the Department of Finance, in consultation with the CRA, and will be completed by August 31, 2017. The Government will also develop a plan to update any exchange relationships identified as not meeting the international standard by either the Global Forum or the Department of Finance.

Recommendation 12: The Minister of National Revenue address offshore non-compliance with tax laws through greater collaboration with other jurisdictions, including through enhanced joint audits with tax treaty partners.

The Government of Canada supports this recommendation. Tax evasion and aggressive tax avoidance is a global problem and requires international collaboration. The Government of Canada is committed to actively collaborating with the growing global network of tax administrations and international bodies that work together to address offshore non-compliance and fight international tax evasion and aggressive tax avoidance.

In May 2016, the Minister of National Revenue signed the Multilateral Competent Authority Agreement with its OECD and G-20 partners to formalize the sharing of information contained in new BEPS-related large business reporting requirements, Country by Country Reporting (CbCR). CbCR will enhance transparency for tax administrations by providing tax authorities with increased information for risk assessment. This information will be shared between jurisdictions that have a legal framework in place for the automatic exchange of CbCR information.

The Government of Canada will continue to actively participate in various global initiatives through the OECD's Forum on Tax Administration, the Financial Action Task Force, the Global Forum on Transparency and Exchange of Information for Tax Purposes and the Taskforce on Tax Crimes and Other Crimes, and will lead or engage in two projects a year.

Recognizing that all exchanges with treaty partners are protected under treaty, Canada will seek opportunities to publish statistical information on the number of taxpayer exchanges with other jurisdictions involving risk assessment, simultaneous or joint audits, and criminal investigations.

Recommendation 13: The Canada Revenue Agency take a lead role in ensuring global implementation of the recommendations by the Organisation for Economic Co-operation and Development and the Group of Twenty in relation to their Base Erosion and Profit Shifting Project.

The Government of Canada supports this recommendation. As a member of the G20 and the OECD, Canada has endorsed the package of recommendations developed to address BEPS and is actively engaged in domestic implementation, and taking on a leadership role through pursuing widespread international implementation, of the BEPS minimum standards. The BEPS project outputs include recommendations for domestic and international action to address aggressive international tax planning, and to ensure that profits are taxed where economic activities are performed.

As part of the Government of Canada's commitment to protect the integrity of the Canadian tax base, the CRA and the Department of Finance have already acted on certain recommendations of the BEPS project, as outlined in Budget 2016:

- The Government has tabled new legislation to strengthen transfer pricing documentation by introducing Country by Country Reporting for large multinational enterprises;
- The CRA is applying revised international guidance on transfer pricing by multinational enterprises, which provides an improved interpretation of the arm's-length principle;

- The CRA will undertake spontaneous exchanges with other tax administrations of tax rulings that could potentially give rise to BEPS concerns; and
- Canada is participating in international work to develop a multilateral instrument to streamline the implementation of treaty-related BEPS recommendations, including addressing tax treaty abuse. On November 24, 2016, the text of the multilateral instrument was adopted by more than 100 countries, including Canada, that participated in the negotiations. Adoption of the text does not bind countries; the next step is for countries to decide whether they want to sign the multilateral instrument. The signing ceremony will be held in June 2017, in Paris. The new instrument will transpose results from the BEPS Project into more than 2,000 tax treaties worldwide.

The Government, through the Department of Finance in collaboration with the CRA, will continue to examine the remaining BEPS recommendations to ensure a coherent and consistent approach.

The Government of Canada, through the CRA and the OECD's Forum on Tax Administration, which includes over 30 tax authorities, will develop a report providing practical guidelines for implementation of an important BEPS action item related to risk assessment and reporting by large multi-national enterprises. The report will be released in spring 2017.

Recommendation 14: The Minister of National Revenue conduct a broad-based review of the Canada Revenue Agency's code of conduct for current employees and employees who are leaving the Agency. This review should be completed by 31 March 2017.

The Government of Canada supports this recommendation. The CRA recognizes the importance of integrity, maintaining Canadians' trust, and has already taken action.

In May 2016, the Minister of National Revenue tasked the CRA Board of Management with conducting a review of CRA instruments that deal with the issues of conflict of interest and post-employment. This included the CRA *Code of Integrity and Professional Conduct*, and the *Directive on Conflict of Interest, Gifts and Hospitality, and Post-employment*. This review and the associated summary of observations have been completed and highlight opportunities to strengthen the CRA's post-employment instruments and approach to post-employment situations. An action plan has been developed, and a senior level inter-disciplinary Post-employment Committee (PEC) has been struck. The PEC is tasked with implementing the action plan items within an aggressive timeline.