50 YEARS of Cutting and Pasting

Modernizing Canada's Tax System

February 2019

This report was made possible by the generous support of our sponsors

Title Sponsors

Panel Sponsors

Tax Advisory Panel

Bruce Ball, Vice-President of Taxation, CPA Canada

Victor Gomez, Director of Government and Regulatory Affairs, Sun Life Financial

Chris Gray, Executive Director, Tax-Filer Empowerment Canada

Guy Legault, President, Conference for Advanced Life Underwriting

Fred O'Riordan, National Leader, Tax Policy, EY

Craig Webster, National Leader, Tax Group, Borden Ladner Gervais LLP

This report was prepared by Dr. Trevin Stratton, PhD, Chief Economist, Canadian Chamber of Commerce. Dr. Stratton is an award-winning business economist, specializing in global and technological change. For more information, contact tstratton@chamber.ca.

Introduction

The last time Canada undertook a comprehensive review of its tax system, humankind had yet to set foot on the moon. In the five decades since, repeated cutting and pasting has left Canadian taxation uncompetitive, cumbersome and inefficient.

Much has changed since the Carter Royal Commission created the basis of our tax system. New technologies, global supply chains and international competition have disrupted entire industries. Governments worldwide are competing to harness innovation by trying to understand how new developments, like artificial intelligence and the sharing economy, will reshape our lives and how we work, including how we tax.

Over the past year, the Canadian Chamber of Commerce heard from members of the business community from all sectors and regions of the country on their views of Canadian tax competitiveness and how to modernize Canada's system of taxation. We heard that Canada's outdated tax system has real costs—in terms of both money and time—for Canadian businesses.

Our consultations included interviews and roundtables with more than 80 business leaders and senior tax practitioners as well as tax policy resolutions from our network, representing more than 200,000 Canadian businesses. The consensus of the Canadian business community is loud and clear: We need a comprehensive review, with everything on the table, to create a modern tax system that can help build a Canada that wins.

We heard a competitive tax system should provide businesses with the capital to invest in the technologies and tools needed to adapt to the speed of change and thrive in this new economy. It should help attract and retain the best and brightest, drive business investment decisions, unleash innovation and empower the next generation of change makers.

Digital technologies also provide the opportunity to take tax compliance to the next level by further improving standardization and automation, promoting greater efficiency and elevating the customer experience. Properly addressing how we tax the digital economy can level the playing field for Canadian businesses and ensure digital companies are treated in a fair, growth-friendly way.

These are exciting times in tax policy. From the United States to Japan, our largest trading partners have been laser-focused on enhancing

their competitiveness through targeted tax reforms and comprehensive reviews of tax systems around the world. By simplifying their tax systems, these countries have enabled companies to spend more time running their businesses so they can expand to new markets and develop innovative products and services.

In comparison, our members believe Canada's tax system hampers investment and talent attraction. A recent statement by the International Monetary Fund (IMF) recommends "a careful rethink of corporate taxation to improve efficiency and preserve Canada's position in a rapidly changing international tax environment."[1]

Given the competitive environment we are in, Canadian businesses believe we need to seize the opportunities that are within our control. Simply welding new parts onto an expired model, complete with the antiquated principles that underpin it, will not resolve our tax competitiveness issues. Instead, Canada must create an internationally competitive system of business taxation that rewards entrepreneurship; encourages businesses to invest in the technologies, skills and capacity they need to grow; and attracts capital and highly qualified people from around the world.

In the following pages, we lay out what we heard through our tax consultations along with the principles and recommendations of the Canadian business community for conducting a comprehensive review of the Canadian tax system. If Canada is serious about adapting to Industry 4.0, we need to focus on how governments can use tax policy to harness disruption and new global business models. Now more than ever, it is crucial we recognize that a modernized tax system can be a key driver of Canada's business innovation and economic growth.

1 International Monetary Fund, "Canada: Staff Concluding Statement of the 2018 Article IV Mission," International Monetary Fund, June 4, 2018, www.imf.com (accessed Jan. 18, 2019).

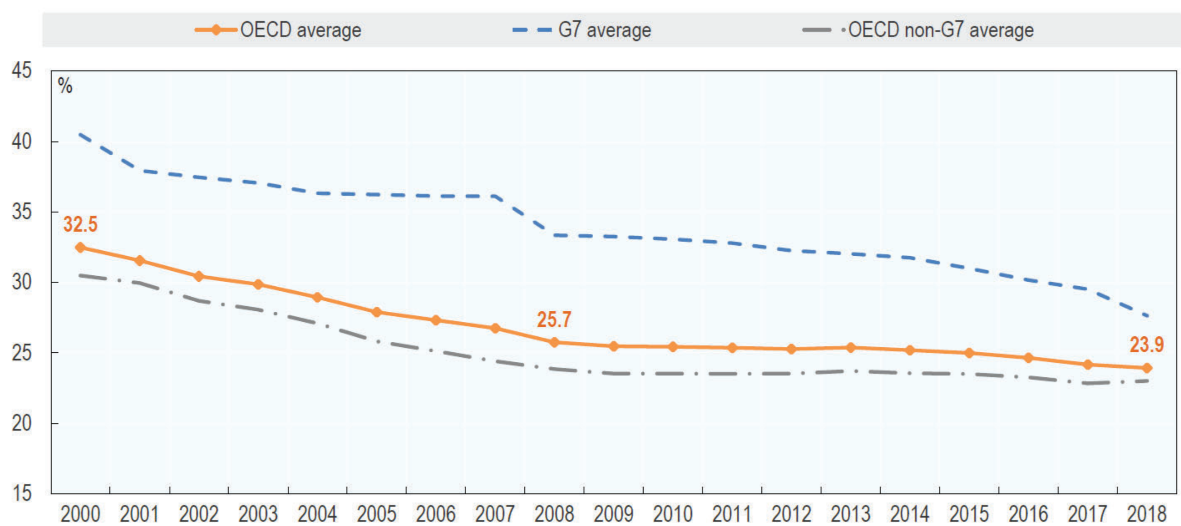
Why Is Canada Falling Behind?

Canadian businesses are being forced to contend with heightened economic competition between countries in a zero-sum environment.

The implications for Canada are profound given that other countries have been focused on implementing policies that will help their national economies and businesses compete and win at home and abroad.

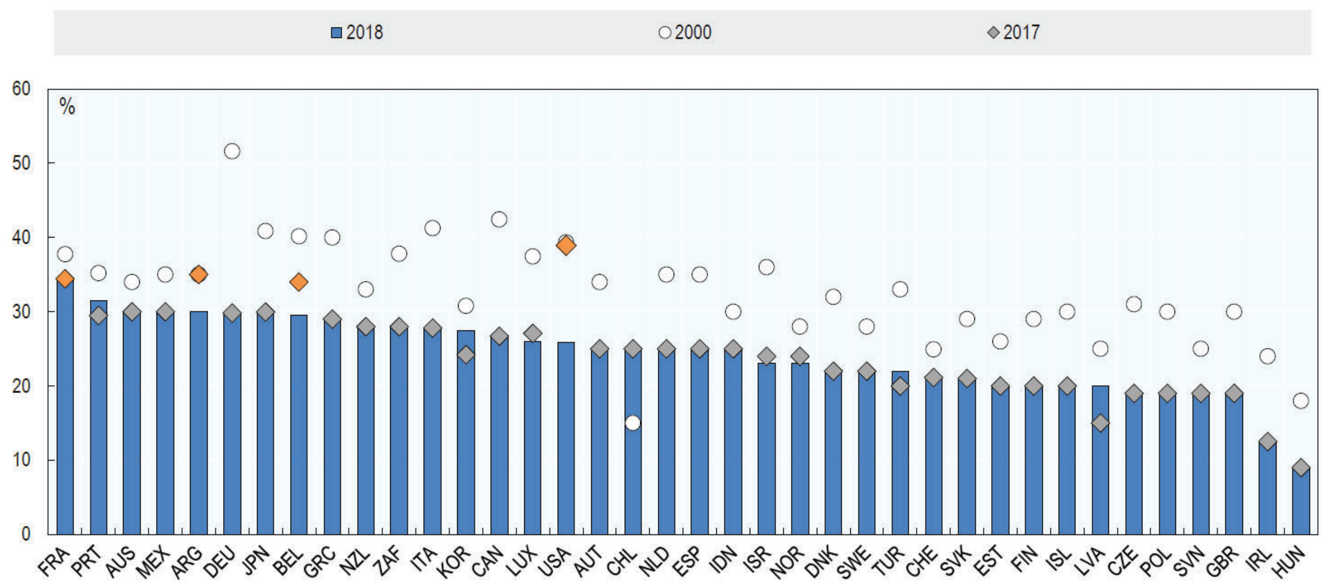
A consistent opinion among members of the Canadian Chamber of Commerce is that Canada cannot continue crawling forward while other countries leap ahead in tax policy. If we do, our companies will continue to fall behind. While Canada does not control many of the factors that can influence competitiveness, we do control some—and domestic tax policy is one of them. If we look at the G7 and the Organisation for Economic Co-operation and Development (OECD), it is clear that, overall, there is a prolonged trend toward greater tax competitiveness. This trend can be seen in the figures that follow, where both the average corporate income tax (CIT) rates and the top combined statutory CIT rates have been trending downward. Canada has to act now to ensure we keep pace during these transformative times in tax policy.

Average corporate income tax rates in OECD G7 and non-G7 countries, 2000–2018



Source: OECD, *Tax Policy Reforms 2018: OECD and Selected Partner Economies* (Paris: OECD Publishing, 2018), 69.

Top statutory corporate income tax rates in 2000, 2017 and 2018: combined (national and subnational) rates



Source: OECD, *Tax Policy Reforms 2018: OECD and Selected Partner Economies* (Paris: OECD Publishing, 2018), 68.

Within this context, many of the world's most developed economies—and some of Canada's largest trading partners—have implemented or are pursuing major tax reforms. From the United States and Belgium to Hong Kong and Japan, many developed countries have announced targeted tax reform initiatives since 2015. The United Kingdom, New Zealand and Australia have also put their tax systems up for full-scale reviews over the past decade. The following page includes two case studies on the examples of the United States and New Zealand.

National tax reforms since 2015

- Australia
- Austria
- Belgium
- France
- Hong Kong
- Hungary
- Japan
- Luxembourg
- Netherlands
- Norway
- United States

Source: CPA Canada, *International Trends in Tax Reform: Canada is Losing Ground* (Toronto: CPA Canada, 2018), 8.

Targeted tax reform case study: U.S. Tax Cuts and Jobs Act

In December 2017, the Tax Cuts and Jobs Act was signed into law in the United States. Its purpose was to stimulate investment in the United States, enhance the competitiveness of American firms and incentivize U.S. multinationals to repatriate income held abroad. The major business tax reform measures in the legislation include:

- A reduction in the federal corporate statutory tax rate from 35% to 21%.
- Immediate full expensing for investment in qualified property through 2022 and partial expensing from 2023 through 2026.
- Repatriation of foreign earnings/participation exemption—international reforms providing for a 100% participation exemption ("territorial") tax system for some foreign earnings.
- Expansion of prior anti-deferral rules by subjecting other active foreign earnings to immediate U.S. taxation by the creation of a global minimum tax.
- A base erosion and anti-abuse tax on certain "base erosion payments" paid to foreign affiliated companies.

Source: PwC, The Impacts of U.S. Tax Reform on Canada's Economy (Toronto: PwC, 2018), 11.

Comprehensive review case study: New Zealand's Tax Working Group Review

New Zealand's Tax Working Group Review was approached as a joint effort by government, academics and tax professionals. Tax officials provided input in developing the agenda, and the review was supported with analytical and other government-provided resources. The working group put forward 13 major recommendations, many of which were adopted in a major tax overhaul in 2010.

These recommendations include:

- New Zealand's company tax rate needs to be competitive with other countries' company tax rates, particularly that in Australia.
- The top personal tax rates of 38% and 33% should be reduced as part of an alignment strategy and to better position the tax system for growth.
- The GST rate should be increased to 15%, which would have merit on efficiency grounds because it would result in reducing the taxation bias against saving and investment.
- Base-broadening should be pursued to address some of the existing biases in the tax system and to improve its efficiency and sustainability.

Source: Victoria University of Wellington Tax Working Group, *A Tax System for New Zealand's Future* (Wellington: Victoria University of Wellington, 2010), 10–11.

The case for a comprehensive review of the Canadian tax system

Apart from targeted U.S. tax measures and the general global trend in tax reform, Canadian businesses expressed their concern that a number of other factors—specifically, trade and regulatory uncertainty—have compounded the negative impact on Canadian economic competitiveness. As a result, international organizations have begun to assert that now is the time for Canada to undertake a comprehensive review of its tax system with a view to enhancing competitiveness.

For instance, the OECD has encouraged Canada to "[r]eview the tax system to ensure that it remains efficient—raising sufficient revenues to fund public spending without imposing excessive costs on the economy—equitable and supports the competitiveness of the Canadian economy."[2] Similarly, the IMF's executive board of directors has suggested Canada conduct "a careful and independent review of the overall Canadian tax system, weighing the pros and cons of incremental versus more radical approaches, and assessing their revenue implications and potential spillovers to other countries."[3]

The Canadian business community agrees the current changing global tax environment not only provides an excellent opportunity for Canada to rethink its own system, but practically requires it.

2 OECD, "Economic Survey of Canada: Executive Summary," June 2018, www.oecd.org (accessed Jan. 18, 2019).

3 International Monetary Fund, *Canada: 2014 Article IV Consultation – Press Release, Staff Report; and Staff Statement* (Washington, D.C.: IMF Publication Services, July 2018), 18.

The Costs of Our Tax System

Throughout our consultations for this study, the Canadian companies we spoke with cited a number of issues with Canada's current tax system that have real costs and implications for strategic, tactical and operational decisions.

These issues have been categorized into three broad themes: business investment; talent attraction, retention and productivity; and administrative burden. The business community consistently mentioned the pace of change in today's economy requires capital investments, investments in talent and organizational agility to keep up and compete. Fostering a tax system that promotes this will help policy-makers support businesses and position them for success.

Business investment

Canadian businesses expressed the view that capital is highly mobile in today's globalized world. Businesses can choose to invest in any number of countries to find the highest rate of return. This means companies will look for tax environments with lower rates on investment to maximize their after-tax rate of return. If a country's tax rate is uncompetitive, it will drive investment elsewhere, leading to slower economic growth.

For example, in April 2018, in response to U.S. tax reform, renewable energy company NextEra Energy Partners decided to sell its wind and solar generation assets in Ontario, totalling $582.3 million US, to the Canada Pension Plan Investment Board.[4] Jim Robo, Chairman and CEO, said in a statement: "We expect the sale of the Canadian portfolio to enable us to recycle capital back into U.S. assets, which benefit from a longer federal income tax shield and a lower effective corporate tax rate, allowing NextEra Energy Partners to retain more … in the future for every $1 invested."[5]

According to research from the OECD, income taxes—specifically corporate taxes—are most harmful to economic growth.[6] Taxing consumption and property appears to adversely affect GDP less significantly than taxing income.[7] Based on the International Tax Competitiveness Index, Canada's corporate taxes rank 22nd in the world and its personal income taxes rank 23rd.[8] Meanwhile, Canada's consumption taxes are rather competitive globally, ranking eighth in the

4 Ali Taghva, "Even green companies are leaving Canada," *The Post Millennial*, Apr. 4, 2018, www.thepostmillennial.com (accessed Jan. 18, 2019).

5 Ibid.

6 Asa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, "Tax and Economic Growth," *Economics Department Working Paper* No. 620 (Paris: OECD, 2008).

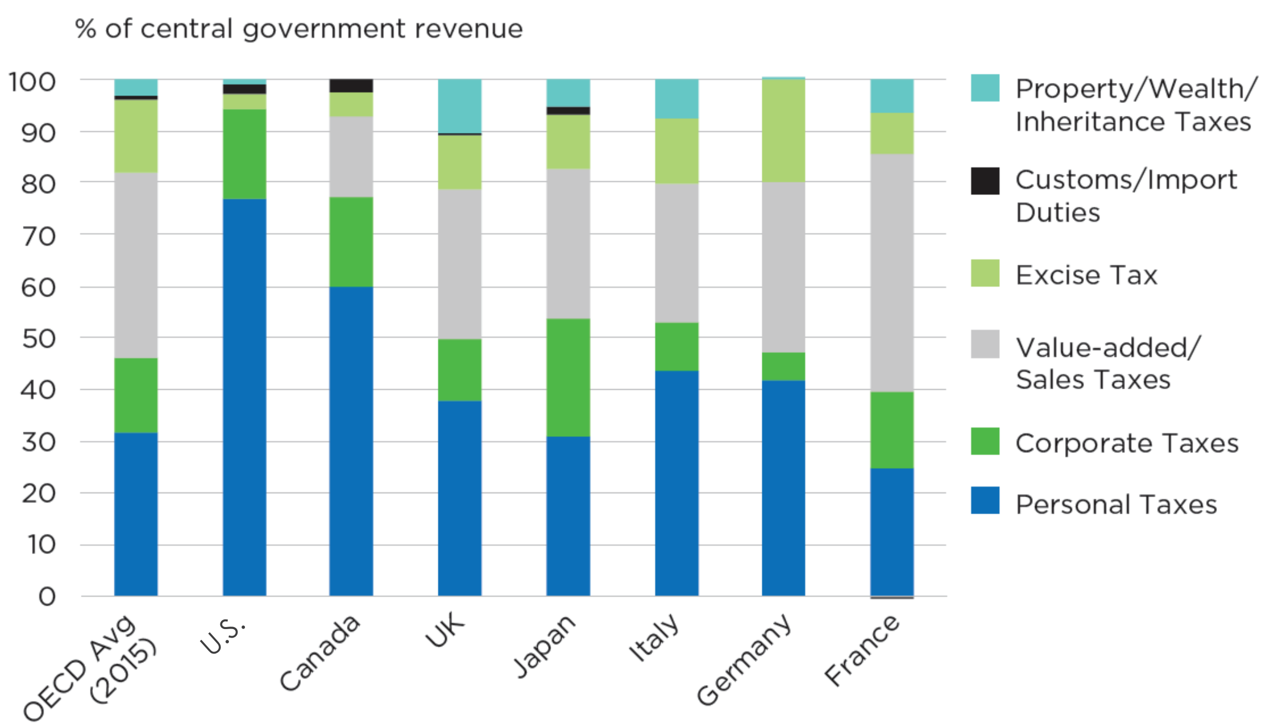
7 Ibid.

8 Daniel Bunn, Kyle Pomerleau and Scott A. Hodge, *International Tax Competitiveness Index 2018* (Washington, D.C.: Tax Foundation, 2018), 3.

world.[9] OECD's Tax Database demonstrates that, compared to its G7 and OECD peers, Canada's tax mix relies more heavily on corporate and personal income taxes and less on consumption taxes, excise taxes and property/wealth/inheritance taxes.[10] Canadian businesses mentioned such a tax mix might contribute to Canada's lagging structural transition from economic growth based on consumption and housing to growth driven by investment and exports.

Our tax system was also not built for today's digital economy. This misalignment of an outdated tax system with the digital economy results in federal and provincial governments depriving themselves of important tax revenues, forcing them to garner more from income taxes. As an example, a number of businesses consulted lamented that foreign companies with no assets or employees in Canada are selling intangible products to Canadian consumers but are not required by current tax regulations to collect and remit sales taxes to federal and most provincial governments.[11] Apart from the impact on the tax mix, this situation puts Canadian businesses at a disadvantage relative to foreign companies because Canada's consumption taxes make the price of goods and services higher than those of non-Canadian companies.

Income tax mix of G7 countries vs. OECD average, 2016 or latest



Source: CPA Canada, International Trends in Tax Reform: Canada is Losing Ground (Toronto: CPA Canada, 2018), 15.

9 Ibid.

10 OECD, "Tax Database," OECD, www.oecd.org (accessed Jan. 18, 2019).

11 Quebec recently implemented digital sales tax, effective January 1, 2019.

According to the OECD's 2018 Economic Survey of Canada, we need a review of our national tax system to address the diminished attractiveness of investing in Canada caused by the impact of U.S. tax reforms.[12] Prior to U.S. tax reform, Canadian capital-intensive sectors were already generally lagging their U.S. counterparts in both GDP growth and investment growth.[13] In our roundtable discussions on tax competitiveness, the Canadian business community unequivocally stated that last year's U.S. tax reform eliminated one of Canada's main competitive advantages for investment attraction and retention.

PwC finds that, all else being equal, the Canadian economy as a whole will likely face a significant shift in investments from Canada to the United States over the next 10 years.[14] It is estimated that U.S. tax reform puts at risk approximately $85 billion Cdn in GDP (or 4.9% of Canada's GDP), 635,000 employees (or 3.4% of Canadian employment), $47 billion Cdn in labour income and $20 billion Cdn in government revenue.[15] These figures do not include the loss of opportunity to establish new industries or expand existing industries as a result of a burgeoning digital economy.

As a partial response, the Canadian federal government announced targeted tax measures in its 2018 Fall Economic Statement. This announcement created immediate changes to Canada's tax system, accelerating investment by:

- Allowing businesses to immediately write off the cost of machinery and equipment used in the manufacturing or processing of goods.
- Allowing businesses to immediately write off the full cost of specified clean energy equipment.
- Introducing an Accelerated Investment Incentive to boost investor confidence.

While it welcomes the government's recognition of this problem, the Canadian business community believes these measures fall well short of what is needed and add greater complexity to a patchwork system. The federal government estimates these changes will result in Canada having the lowest marginal effective tax rate (METR)—the average overall tax rate on new business investments—in the G7.[16] However, that METR will only apply to businesses that are in a position to fully utilize these measures. And the measures themselves are only temporary: they will all be phased out between 2024 and 2027. It remains to be seen whether these measures will increase the overall level of business investment in Canada as opposed to just accelerating planned investments that would otherwise be undertaken a few years earlier.

12 OECD, "Economic Survey of Canada: Executive Summary," OECD, June 2018, www.oecd.org (accessed Jan. 18, 2019).

13 PwC, *The Impacts of U.S. Tax Reform on Canada's Economy* (Toronto: PwC, 2018), 4.

14 Ibid.

15 Ibid, 5.

16 Department of Finance Canada, *2018 Fall Economic Statement: Investing in Middle Class Jobs* (Ottawa: Department of Finance Canada, 2018), 59.

17 U.S. tax reform will reduce the value of Canadian SR&ED credits to U.S. corporations conducting R&D in Canada. The new rules now mean that U.S.-based corporations do not receive the full benefits of foreign tax credits, such as the Canadian SR&ED credits. In addition, income generated with intellectual property developed and commercialized in the United States will be subject to a slightly lower tax rate in the United States and a significantly lower rate when that income is generated from export activities. A U.S.-based company that develops intellectual property in Canada and subsequently commercializes that intellectual property in the U.S. will incur additional tax cost.

Immediate Expensing and the Accelerated Investment Incentive Will Allow Businesses to Recover Investment Costs Sooner

Table 3.1
Illustrative Impact of Proposed Measures on Selected Assets, Deduction in the First Year

	Normal	With Proposed Measures (maximum 100%)
Immediate Expensing		
Manufacturing and processing machinery and equipment	25%	100%
Clean energy equipment	25%	100%
Accelerated Investment Incentive		
Computer software	50%	100%
Computers	27.50%	82.50%
Trucks and tractors for hauling freight	20%	60%
Motor vehicles	15%	45%
Earth-moving equipment	15%	45%
Data network infrastructure equipment	15%	45%
Aircraft	12.50%	37.50%
Office equipment	10%	30%
Fibre-optic cables	6%	18%
Buildings used in manufacturing and processing	5%	15%
Other non-residential buildings	3%	9%
Goodwill[1]	2.50%	7.50%
Other[2]	Variable	Up to 3x normal rate

1 Goodwill is an intangible business asset that is linked to the established reputation of a business. In practice, goodwill is the difference between the price paid to acquire a business and the value of the net assets (e.g., buildings, equipment) acquired during the sale.

2 The category "other" includes all other capital assets, including intangible capital assets, that are not presented in this table.

Source: Department of Finance Canada, 2018 Fall Economic Statement: Investing in Middle Class Jobs (Ottawa: Department of Finance Canada, 2018), 58.

Like many other countries, Canada and the United States both offer tax credits designed to encourage R&D activity. Overall, Canadian businesses are concerned that U.S. tax reform might decrease the effectiveness of Canada's Scientific Research and Experimental Development (SR&ED) credits for U.S.-based companies and increase the effectiveness of U.S. R&D credits.[17] This is likely to lead to a reduction in R&D activity by U.S.-based companies in Canada, including the spillover benefits that such activity creates. Currently, R&D conducted by U.S. companies in Canada accounts for at least 11% of total private R&D spending in Canada.[18]

18 PwC, *The Impacts of U.S. Tax Reform on Canada's Economy* (Toronto: PwC, 2018), 7.

Talent attraction, retention and productivity

The talent pool is consistently ranked as one of the top reasons investors choose Canada. In its 2018 World Competitiveness Ranking, the Swiss business school IMD found the top two investment attraction indicators for Canada were its high education level and skilled workforce.[19]

The Canadian business community is concerned the lower personal income tax rates introduced by U.S. tax reform will likely increase the net income gap between the two countries, especially in highly skilled occupations.[20] The net income gap is already substantial due to higher wages and lower personal income taxes in the U.S., which makes Canada less attractive to highly skilled workers at a time when demand for skills is high and growing.

U.S. single filers

Under previous law		Under current law	
Rate	**Income bracket (US)**	**Rate**	**Income bracket (US)**
10%	$0–$9,525	10%	$0–$9,525
15%	$9,525–$38,700	12%	$9,525–$38,700
25%	$38,700–$93,700	22%	$38,700–$82,500
28%	$93,700–$195,450	24%	$82,500–$157,500
33%	$195,450–$424,950	32%	$157,500–$200,000
35%	$424,950–$426,700	35%	$200,000–$500,000
39.6%	$426,700 and up	37%	$500,000 and up

Source: Internal Revenue Service, "2018 Federal Tax Rates, Personal Exemptions, & Standard Deductions," IRS, www.irs.com (accessed: Jan. 18, 2019).

The U.S. tax reform marginally increases incentives for highly skilled Canadian workers to relocate to the U.S., which makes it more difficult for Canadian businesses to attract and retain highly skilled foreign workers. PwC finds the net impact of the U.S. tax reform will likely be limited to an incremental increase in emigration of a few thousand employees per year.[21] However, it will come at a time when Canada needs to reverse the existing "brain drain" phenomenon to ensure it emerges as a "winner" from the digital revolution it will likely face over the next five to 10 years.[22]

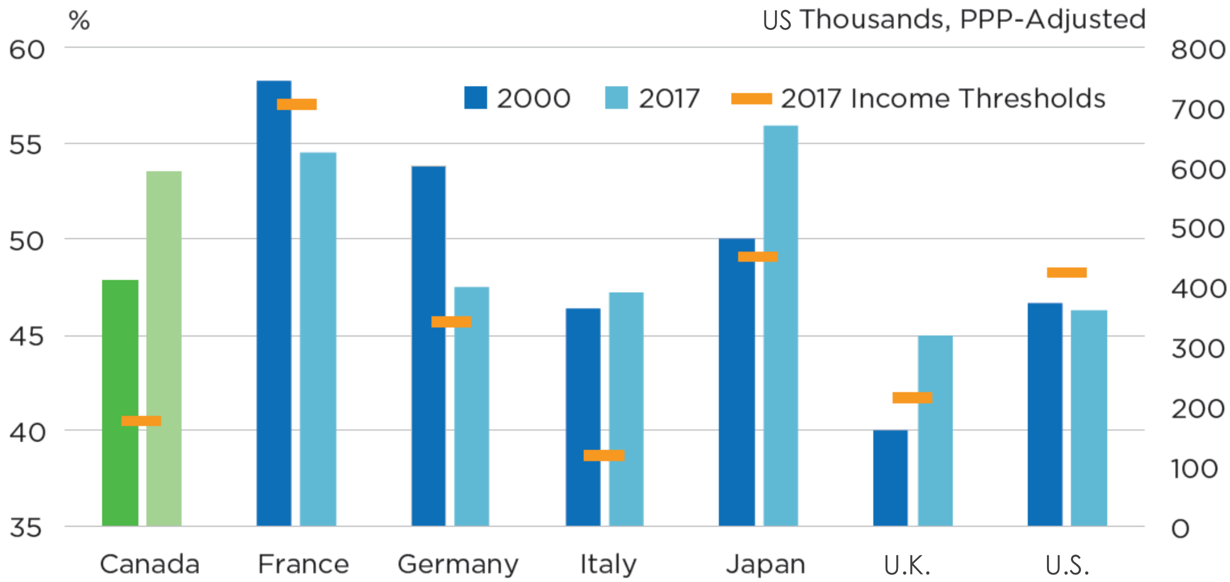
19 IMD, *2018 World Competitiveness Ranking: Canada* (Lausanne: IMD, 2018).

20 PwC, *The Impacts of U.S. Tax Reform on Canada's Economy* (Toronto: PwC, 2018), 7.

21 Ibid.

22 Ibid.

Top statutory combined national-subnational personal income tax rates and income thresholds - G7 countries



Source: CPA Canada, International Trends in Tax Reform: Canada is Losing Ground (Toronto: CPA Canada, 2018), 14.

Canadian businesses are concerned the personal tax bracket structure on high-income earners will drive highly skilled workers to the United States. The combined federal-provincial rate in Ontario reaches 53.53%, the third highest in the G7.[23] Canada's highest top statutory personal tax bracket kicks in at a much lower level of income compared to the other G7 countries. Canada's top rate takes effect at a purchasing power parity-adjusted $174,592 US, less than half the average of the remaining six countries, which kick in at $375,312 US, as of 2017. Only Italy's top threshold is lower.[24]

As shown in the table that follows, Canada's top marginal income tax rate is now the seventh highest among 33 OECD countries (about seven points higher than the top U.S. rate, after recent tax reforms there). Moreover, unlike France, Japan, Portugal and the U.S., Canada defines someone to be a "high earner" at a much lower income level relative to the average national wage.[25]

23 CPA Canada, *International Trends in Tax Reform: Canada is Losing Ground* (Toronto: CPA Canada, 2018), 14.

24 Ibid.

25 Jack Mintz, "Ottawa can't keep squeezing crazy rich Canadians. Or barely rich ones," *National Post*, Jan. 10, 2019, www.nationalpost.com (accessed Jan. 18, 2019).

Countries with the highest top marginal personal tax rates compared to the United States, 2018

Country	Top marginal tax rate	Top bracket as a multiple of average wage
United States	46.3%	8.0
Sweden	57.1%	15.6
Portugal	56.2%	15.6
Japan	55.9%	8.5
Denmark	55.8%	1.3
France	54.5%	14.6
Greece	54.0%	3.9
Canada	53.5%	4.3

Source: OECD, "Tax Database," OECD, www.oecd.org (accessed: Jan. 18, 2019).

The Canadian business community is also wary of the impact of the tax system on Canada's already flagging productivity levels. Throughout consultations, members of the Canadian Chamber of Commerce repeatedly pointed out that U.S. tax reforms exacerbated a productivity problem that has existed for far too long in Canada.

Productivity growth has historically accounted for much of the wage growth in Canada. Between 1961 and 1970, annual productivity growth was particularly strong, averaging 3.2%, and growth in real hourly wages averaged 3.7%.[26] For the next four decades, productivity growth generally held steady in the range of 1% to 2%.[27] However, since 2011, productivity growth has declined drastically, with an average annual growth of just 0.4%.[28] It is not such a surprise, then, that wage growth has been the weakest of any of the previous five decades. The latest figures suggest that Canadian businesses will invest about $13,900 per worker in 2018.[29] By contrast, businesses across the OECD will invest about $19,700 per worker and businesses in the United States will invest about $23,200 per worker.

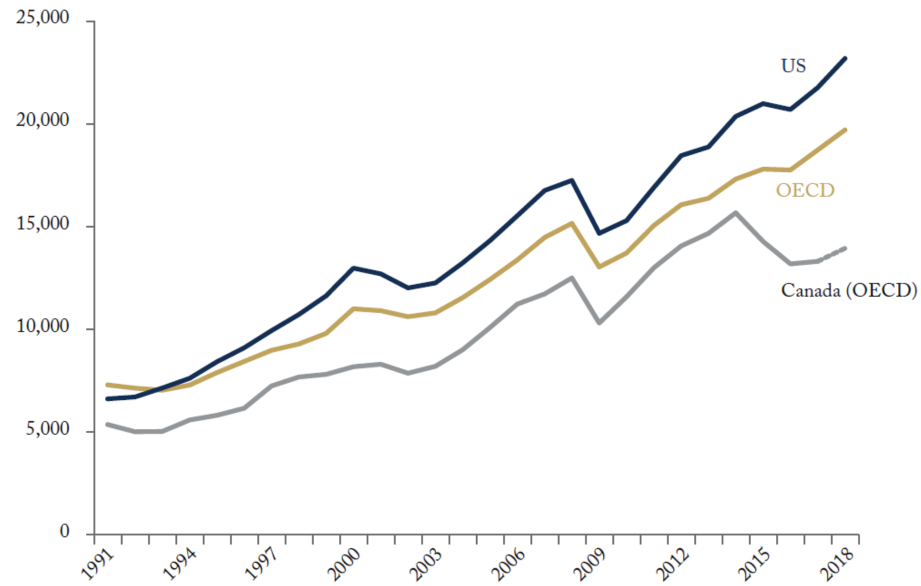
26 Francois Dupuis and Jimmy Jean, *The Causes and Consequences of Low Wage Growth in Canada* (Montreal: Desjardins, 2017), 1.

27 Ibid.

28 Ibid.

29 William B.P. Robson, Jeremy Kronick and Jacob Kim, "Tooling Up: Canada Needs More Robust Capital Investment," *C.D. Howe Institute Commentary No. 520* (September 2018), 1.

Non-residential business investment per worker, Canadian dollars, 1991-2018



Source: William B.P. Robson, Jeremy Kronick, and Jacob Kim, "Tooling Up: Canada Needs More Robust Capital Investment," *C.D. Howe Institute Commentary No. 520* (September 2018), 5.

In general, advanced sector[30] productivity is lower in Canadian cities than in American ones—and this trend appears to be getting worse. Between 1996 and 2015, the productivity gap (i.e., the relative difference in productivity) between Canadian and American advanced sector workers grew from 17% to a staggering 100%.[31] Surprisingly, the gap for U.S. and Canadian workers in non-advanced sectors stayed the same during this period, which means the growing productivity gap among advanced sectors workers has actually brought down the overall productivity level of the average Canadian worker.[32]

We know from various economic studies that high marginal personal tax rates reduce economic growth. They discourage work effort, investment and risk-taking by both entrepreneurs and highly paid skilled labour.

30 Characterized by its deep involvement with technology R&D and STEM (science, technology, engineering and math) workers, the advanced sector ranges from manufacturing industries (e.g., automotive, aerospace) to energy industries (e.g., oil and gas extraction) to high-tech services (e.g., computer software and computer system design, including for health applications). The advanced sector comprises high-value innovation and technology application industries that inordinately drive regional and national prosperity. Such industries matter because they generate disproportionate shares of any nation's output, exports and R&D.

31 Mischa Kaplan, "Our problem's not just Trump. Canada still lags in advanced industry," *Ottawa Citizen*, Jun. 18, 2018, www.ottawacitizen.com (accessed Jan. 18, 2019).

32 Ibid.

Administrative burden

The IMF executive board of directors points out that targeted domestic tax changes in Canada over the years have added complexity to Canada's overall tax system.[33] Canadians face a dauntingly byzantine federal tax system that is filled with boutique tax credits and is complicated by a collection of piecemeal changes implemented by successive governments often driven by short-term political issues rather than good tax policy. At 3,220 pages, Canada's Income Tax Act has become bloated, with the tax system now including a patchwork of 209 tax credits, incentives and narrow fixes.[34] It is no surprise the Canada Revenue Agency (CRA) received 53.5 million calls in the 2016–2017 tax year.[35] The complexity of the system, as a result, also supplies a hidden cost to taxpayers funding CRA call centres.

Overall, Canada ranks 41st in the world in the time required to prepare and pay taxes, taking an average of 131 hours to do so in 2017.[36] This administrative burden has risen from an average of 119 hours in 2009.[37] This means more time spent away from family, from running a business or on other productive pursuits.

As *National Post* columnist Andrew Coyne noted: "Put simply, the Canadian tax system is a creaking, productivity-killing wreck: hugely over-complicated, and riddled with unjustified deductions and exemptions that distort economic decisions and bleed the government of revenues, recouped by much higher tax rates than would otherwise be the case."[38]

Time to prepare and pay taxes (2017)

Selected countries	Hours
United Arab Emirates	12
Luxembourg	55
Switzerland	63
Singapore	64
Hong Kong	72
Ireland	82
Norway	83
Finland	93
Australia	105
U.K.	110
Netherlands	119
Sweden	122
Denmark	130
Austria	131
Canada	131
U.S.	175

Source: World Bank, "Time to prepare and pay taxes (hours)," World Bank Doing Business Project, 2017, www.doingbusiness.org (accessed Jan. 18, 2019)

33 International Monetary Fund, *Canada: 2014 Article IV Consultation – Press Release, Staff Report; and Staff Statement* (Washington, D.C.: IMF Publication Services, July 2018).

34 CPA Canada, "Why Canada Needs a Tax Review," CPA Canada, 2018, www.cpacanada.ca (accessed Jan. 18, 2019).

35 Ibid.

36 World Bank, "Time to prepare and pay taxes (hours)," World Bank Doing Business Project, 2017, www.doingbusiness.org (accessed Jan. 18, 2019).

37 Ibid.

38 Andrew Coyne, "Now is the time for broad reform of Canada's productivity-killing tax system," *National Post*, Dec. 15, 2017, www.nationalpost.com (accessed Jan. 18, 2019).

However, in recent years, nearly 90% of taxpayers are now preparing and filing their taxes digitally through do-it-yourself software or with the assistance of professional tax preparers or accounting firms.[39] This partnership between industry and government has the potential to reduce the administrative burden on the taxpayer by allowing the government to focus on tax policy, revenue collection and assessing the accuracy of income tax returns while industry provides user-friendly products to Canadians that help achieve tax compliance.

While the administrative burden of the tax system, as it currently exists, is problematic, it is also not helped by an agency that further frustrates and complicates the lives of business owners. Canadian businesses and tax practitioners report frustration and a need to commit significant time, often at considerable expense, to deal with taxation and filing issues with the CRA. Many of the business members consulted find themselves spending exorbitant amounts of time dealing with the CRA.

When a business makes an error in filing, there are strict timelines placed on correction and response; however, when the CRA is in error, a business may invest significant amounts of time communicating or attempting to communicate with the agency and being transferred from one CRA responsibility centre to another. During consultations, our business members told us that, in many cases, they pay to hire tax professionals to navigate through the complexities of Canada's tax system—and even professionals are challenged by the current circumstances.

In fall 2017, Canada's auditor general tabled a report in the House of Commons that found the CRA actively blocked calls from taxpayers so it could falsely say it met its service standards of keeping people waiting less than two minutes.[40] Between March 2016 and March 2017, the CRA answered only 36% of calls.[41] The report also found that the number of errors made by CRA agents was drastically underreported. The CRA reports a 6.5% error rate, compared to the 30% error rate observed by the auditor general's office.[42]

Throughout our consultations, the Canadian business community—particularly the small business community—mentioned a significant increase in CRA business audit requests asking for additional evidence or information to substantiate claims made on filing documents. Auditors appear to be targeting microexpenses, thereby costing the small businesses much in fees and lost productivity to comply with years-old returns. These requests provide a deadline to comply or assessments will be re-adjusted. To gather the required information and subsequently upload to the CRA's website takes between two to 10 hours per request. With the number of audit requests increasing, the cost of complying is subsequently increased. For many small businesses, these audit requests are becoming unreasonable. Based on the findings of the auditor general, we know that Canadian taxpayers are facing years of delay in objecting to and appealing assessments.[43]

39 Tax-Filer Empowerment Canada, "Written Submission for the Pre-Budget Consultations in Advance of the 2019 Budget," House of Commons Canada, 2018, www.ourcommons.ca (accessed Jan. 18, 2019).

40 Office of the Auditor General of Canada, *2017 Fall Reports of the Auditor General of Canada to the Parliament of Canada: Report 2 – Call Centres – Canada Revenue Agency* (Ottawa: OAG, 2017).

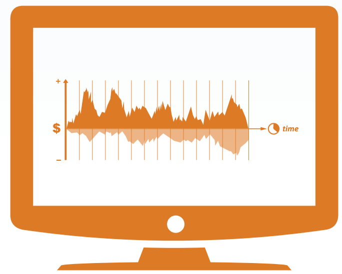
41 Ibid.

42 Ibid.

43 Office of the Auditor General of Canada, *2018 Fall Reports of the Auditor General of Canada to the Parliament of Canada: Report 7 – Compliance Activities – Canada Revenue Agency* (Ottawa: OAG, 2018).

Principles for a Modern Tax System

Canadian business is in strong agreement that a comprehensive review is needed to modernize and improve the Canadian tax system. High-level discussions among companies of all sizes and across all sectors and geographic regions produced consensus on the four principles on which to base a review: competitiveness, simplicity, fairness and neutrality.



Competitiveness

A company's decision to invest is very sensitive to the rate of return on capital. Other things being equal, capital flows into jurisdictions where the rate of return is highest. Taxes imposed on businesses reduce the rate of return and affect both the amount and the location of investment undertaken.

Over the past two decades, many G7 governments have gradually reduced business taxes to attract investment, primarily by implementing staged reductions in corporate tax rates, eliminating taxes on capital and reducing taxes on business inputs. A measure of the effectiveness of this tax policy strategy in Canada is that, despite of the rate reductions over this period, corporate tax revenues have continued to increase, and the ratio of corporate taxable income to GDP has remained stable.[44]

Canada remains middle-of-the-pack among G20 countries when it comes to the competitiveness of its tax rates. However, after U.S. tax reform, we have lost relative tax competitiveness to our largest trading partners and closest neighbour. This does not necessarily mean Canadian tax rates need to be drastically reduced in a race to the bottom, as some critics caution against, but that base-broadening measures need to be explored as a substitute for or complement to any rate reductions.[45]

Simplicity

Simplicity is the concept that all taxpayers can fulfill their tax obligations in a reasonable amount of time and at reasonable expense and, soon after, get certainty about their tax status from tax authorities. For taxpayers, the struggle to comply with increasingly complex provisions of tax legislation has made navigating the tax system more challenging. For many of them, self-assessment and filing of a return are just the beginning of a long and protracted process of dealing with the tax authorities.

Simplicity enhances certainty—and certainty is of critical importance for financial and estate planning by individuals as well as for operational and investment decisions by businesses on

44 OECD, "Chapter 4 – Countries – Tax revenue and % by selected taxes," Revenue Statistics – OECD countries: Comparative tables, www.stats.oecd.org (accessed: Jan. 18, 2019).

45 Fred O'Riordan, "Why Canada Needs a Comprehensive Tax Review", *Canadian Tax Journal* 66, no. 2, (2018): 360.

behalf of their owners and shareholders. As tax provisions have become more complex, bright-line rules and tests that are simple to administer and comply with have become more difficult for tax authorities to write into law. More specific and detailed anti-avoidance rules are required. More guidance and interpretation are also necessary as well as more administrative discretion in decision-making.

In areas of tax that are imprecise or subjective, there is no single right answer in determining tax liability, but a number of right answers within a fairly broad range. These complications invariably lead to more tax controversy, more domestic and international tax disputes to resolve, increased costs and further delays before certainty is obtained. [46]

Fairness

How taxpayers perceive the fairness and integrity of the tax system is important because it can affect their voluntary compliance, which is the cornerstone of our system.[47] If trust and confidence are eroded, behavioural changes can reduce compliance rates and significantly increase enforcement costs.[48] Retroactive tax changes, which create tax uncertainty in planning and significant unwinding costs to taxpayers, can undermine the perception of tax fairness. High tax burdens, in particular, can cause taxpayers to push the boundaries of legal and elicit behaviour. This is especially relevant now that Canada's highest combined federal-provincial marginal rates on ordinary personal income exceed 50% in seven of Canada's 10 provinces.[49]

The public's opinion may be influenced by media reports of high-wealth individuals sheltering income in offshore tax havens or multinational corporations allegedly paying less than their fair share of business taxes, but Canadians would be far better informed by a broad empirical analysis of individual tax burdens and business tax incidence done in the context of a comprehensive policy review.[50]

Neutrality

Many issues remain related to the neutrality and efficiency of Canada's tax system, and there is scope for further improvement. A plethora of tax expenditures still exist, making the tax system a patchwork of varied measures that distort markets.[51] These tax expenditures were designed to achieve once-valid social or economic policy objectives. However, such measures often entail unintended costs in terms of economic efficiency, and they are not necessarily good substitutes for direct expenditure programs that could achieve the same objectives more transparently and with more public scrutiny and accountability. [52] In addition, it is questionable whether many of the tax expenditures that exist in Canada actually achieve their intended objectives.

The recent implementation of new income splitting rules are another example of how the tax system can distort business behaviour, where the rules favour shareholders in businesses that are not offering services.

46 Ibid., 357.

47 Ibid., 361.

48 Ibid.

49 Manitoba (50.40), Ontario (53.53), Quebec (53.31), New Brunswick (53.30), Nova Scotia (54.00), Prince Edward Island (51.37), and Newfoundland and Labrador (51.30).

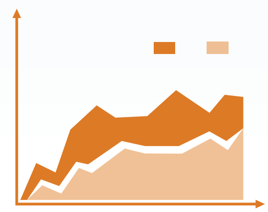
50 Fred O'Riordan, "Why Canada Needs a Comprehensive Tax Review", *Canadian Tax Journal* 66, no. 2, (2018): 361.

51 Department of Finance Canada, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations* (Ottawa: Department of Finance, 2017).

52 Fred O'Riordan, "Why Canada Needs a Comprehensive Tax Review", *Canadian Tax Journal* 66, no. 2, (2018): 361.

Recommendations

Based on the consultations conducted in the course of this study and the policy resolutions passed by its network, the Canadian Chamber of Commerce suggests the federal government adopt the following eight recommendations to improve the tax system in Canada. All eight recommendations should be explored in the context of a comprehensive review.



Recommendation 1:

Appoint a Royal Commission to conduct a comprehensive review of the Canadian tax system

The federal government should appoint a Royal Commission to undertake a whole-of-system review of taxation in Canada. The Royal Commission's terms of reference should be guided by the principles of tax competitiveness, simplicity, fairness and neutrality. The inquiry should have the objective of, within expedient timelines, raising sufficient revenues to fund public spending without imposing excessive costs on the Canadian economy.

Recommendation 2:

Broaden the tax base to explore the most effective tax policy solutions

The federal government should consider base-broadening measures to increase the amount of economic activity subject to taxation. Ending preferential tax treatment—such as unwarranted deductions and exclusions—would create a simpler and more equitable tax code, eliminate distortionary provisions and encourage a more efficient allocation of resources. Perhaps most importantly, broadening the tax base would provide the federal government with the flexibility to improve Canadian tax competitiveness in a fiscally sustainable way.

Recommendation 3:

Adjust the tax mix to better promote business investment and economic growth

The federal government should examine what tax mix will maximize investment in the capital, technologies and skills needed to enhance Canadian economic growth and innovation. Different types of taxation have varying impacts on investment, growth and the progressiveness of the tax system. The federal government should assess how tax mixes in other jurisdictions impact investment and growth, and what best practices can be applied in Canada.

Recommendation 4:

Bridge the digital tax divide to ensure a fair and equitable tax system

The federal government should require foreign digital companies to charge an appropriate value-added tax (e.g., GST/HST) on sales related to the purchase of their services in Canada. Foreign digital companies should also be required to register with the CRA and remit the revenues from these taxes to the proper tax authorities. Bridging the digital tax divide will require the federal government to examine how to apply value-added taxes evenly and predictably across provinces and sectors in a digital world, including an assessment of potential revenue from foreign digital companies.

Recommendation 5:

Further simplify the tax filing experience with digital filing solutions

The federal government should facilitate further collaboration and digital innovation between the tax preparation and software industry and the CRA. This would involve further clarifying the respective roles and commitments of each party, as well as ensuring a comprehensive review does not affect the sustainability of the ecosystem where vendors compete on the ease of their user interface and features provided. Innovative, secure and convenient digital filing services should continue to result in federal government savings as well as free up CRA resources to focus its efforts on critical issues such as investigations and tax evasion.

Recommendation 6:

Legislate a taxpayer charter of rights to hold CRA accountable

The federal government should replace the Taxpayer Bill of Rights with a legislated taxpayer charter of rights that provides recourse for taxpayers in the case of CRA wrongdoing. Any review of the Canadian tax system must also look at those responsible for enforcing it. A taxpayer charter of rights would provide remedies in cases where protocols are proven to be unnecessarily cumbersome or costly, or where the taxpayer is mistreated. Establishing a legislated taxpayer charter of rights would promote fairness and accountability, including clearer guidelines and better training of CRA staff.

Recommendation 7:

Provide a representative for small business to resolve conflicts with CRA

The federal government should provide small businesses with some form of intermediary assistance to understand and navigate tax compliance. This assistance should be structured to enable greater effectiveness and should not require the additional expense of a tax accountant or lawyer to resolve. While a chief service officer has been appointed at CRA and a service advisory panel is being established, small businesses have unique informational and service needs that require a designated representative. By assigning a case officer with the appropriate training to small business files, the federal government can make tax compliance faster, cheaper and simpler.

Recommendation 8:

Conduct regular comprehensive reviews to keep the tax system up to date

The federal government should ensure the tax system is reviewed at regular intervals to prevent it from becoming overly complicated, uncompetitive or outdated. The speed of change is accelerating and Canada's tax system must reflect ongoing economic developments. An independent, impartial body of tax experts should conduct regular reviews to determine whether the tax system is keeping pace with advancements in global tax policy, tax competitiveness trends and new technologies.

Canadian Chamber of Commerce
Chambre de Commerce du Canada

Chamber.ca info@chamber.ca

@CdnChamberofCom CanadianChamberofCommerce @cdnchamberofcommerce