



Certified General
Accountants
Comptables généraux
accrédités

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

August 14, 2008

**100 – 4200 North Fraser Way, Burnaby, BC V5J 5K7 Telephone: (604) 669-3555
1201 – 350 Sparks Street, Ottawa, ON K1R 7S8 Telephone: (613) 789-7771
www.cga-canada.org**

EXECUTIVE SUMMARY

Canada's *Income Tax Act* (ITA) has grown from 11 pages in 1917 to 2,860 pages today (index excluded). What was promoted as a "temporary" measure to underwrite the war effort has become an entrenched feature of the Canadian economy, built on a patchwork of unnecessarily complex and cumbersome rules. Canada's tax system is labour-intensive, costly to administer, full of red tape and difficult to understand.

Fundamental changes to Canada's tax system are imperative.

CGA-Canada recommends that the Government of Canada take immediate and necessary steps to *simplify* Canada's tax legislation and the tax system.

As the following pages reveal, the best way to implement tax simplification is by:

- Appointing an expert panel to undertake a fundamental review of the tax system, with a mandate to simplify Canada's tax legislation;
- Harmonizing provincial sales taxes with the federal goods and services tax in every province;
- Establishing a uniform corporate tax rate, where the general corporate income tax rate is on par with the small business income tax rate;
- Extending the use of "simplified methods" under the *Income Tax Act* and *Excise Tax Act*;
- Tackling the obvious, that is identifying areas which are ripe for reform, or rules which are irrelevant or out of date, and providing consideration to streamlining or even removing these unnecessary provisions in Canada's tax legislation;
- Managing the paper and administrative burden so that any new regulatory requirement is followed by subtracting one outdated or irrelevant rule.

INTRODUCTION

The Certified General Accountants Association of Canada (CGA-Canada) is once again pleased to participate in the annual federal pre-budget consultations undertaken by the House of Commons Standing Committee on Finance. We appreciate the opportunity to be engaged in this public process, as this Committee's report to Parliament will undoubtedly influence the contents of the Government of Canada's next budget. CGA-Canada looks forward to appearing before the House of Commons Standing Committee on Finance in this regard.

CGA-Canada is a national professional accounting organization that represents 68,000 CGAs and students. The association sets standards, develops education programs, publishes professional materials, advocates on public policy issues, and represents CGAs nationally and internationally. CGA is the fastest-growing accounting designation in Canada. The CGA designation focuses on integrity, ethics and the highest education requirements. Recognized as the country's accounting financial leaders, CGAs provide strategic counsel, leadership and direction to all sectors of the Canadian economy. This year marks the 100th anniversary of the CGA designation.

In its news release of June 19, 2008, the Committee has invited Canadians to submit briefs containing "*only one recommendation that reflects your most important federal program spending or taxation priority*". The subject of taxation has always been of vital importance to CGA-Canada. Our association has put forward many tax-related recommendations to the House of Commons Standing Committee on Finance and the Minister of Finance through our annual appearances and written submissions. CGA-Canada has called for redefining fair and competitive taxation, presented suggestions on how to ensure the consistent application of tax legislation, and supported major structural reforms to the tax system to improve Canada's productivity. Moreover, CGA-Canada has recommended that the federal government appoint a panel of experts to undertake a fundamental review of the tax system.

One common thread running through these suggestions is that of tax simplification. This is our central recommendation to the Committee, and our intention is to build on our proposals and bring new ideas to the forefront of discussion.

RECOMMENDATION:

CGA-Canada recommends that the Government of Canada take immediate and necessary steps to simplify Canada's tax legislation and the tax system.

TAX SIMPLIFICATION

The *Income Tax Act* (ITA) has evolved from a few pages of general principles in 1917 to the intricate and exhaustive system that comprises the Act today, with an inordinate array of special rules for a variety of circumstances and transactions that could not have been contemplated 90 years ago. The ITA serves purposes far beyond its original intent, and is criticized as being unnecessarily complex, cumbersome and difficult to understand.

Taxpayers and businesses spend a significant amount of time, energy and money complying with Canada's tax system – at an estimated cost of up to \$30 billion annually, according to the Fraser Institute. The services of professionals, such as accountants and lawyers, are often required to assist with taxation filing requirements. In turn, tax practitioners, advisors and auditors feel strongly that the requirements are complex, and that decisions and interpretations are difficult to obtain on a timely basis. Moreover, for government, the system is costly to administer.

It is clear that Canada's tax system cannot continue on its growth path the way it has for the last several decades and expect to be perceived as a credible and manageable system. Fundamental changes are imperative.

Tax simplification is neither new nor radical, and it has appeared in various forms. The Fraser Institute has published papers and books on the subject – the most recent includes *The Impact and Cost of Taxation in Canada: The Case for Flat Tax Reform*, which examines the rationale for tax reform and lays out a road map towards an entirely new tax system. The Canadian Taxpayers Federation has urged the federal government to embark on comprehensive tax reform with the ambition of adopting a single personal tax rate or "flat tax", and the C.D. Howe Institute conducted an independent analysis of this plan's fiscal impact on government revenues and its affordability.

Governments are also pondering this question. In June, the New Brunswick government announced a formal and comprehensive review of provincial taxation with the release of a discussion paper that presents a series of options and, among other things, is based on the principle of "simplicity."

Tax simplification would bring significant benefits to individual taxpayers, businesses and the Canadian economy as a whole – in the form of increased compliance rates and lower compliance costs for taxpayers, less red tape for businesses and lower administrative costs for government. A simpler, fairer and more efficient tax system would also have a positive impact on tax avoidance activities, including those that flourish in what is known as the underground economy. In short, a simplified system equates to an improved and strengthened system, with a more secure tax base and predictable revenue.

Below are a few guiding principles and suggestions to implement tax simplification:

Expert panel

CGA-Canada continues to believe the federal government must appoint a panel of experts to undertake a fundamental review of the tax system – international and domestic frameworks – as well as how the system affects both businesses and individual taxpayers. While the creation of the *Advisory Panel on Canada's System of International Taxation* is a step forward, its focus is limited to only the international realm and the business sector. Given that taxation affects every single individual in this country, a broad approach that examines the entire system is needed.

The panel should be given a specific mandate to simplify the ITA and GST legislation (*Excise Tax Act*) and consult widely in the context of a public forum, generating debate of the issues at hand. The panellists would bring forward third party recommendations to the Government of Canada, to be tabled in Parliament. The federal government would also table a comprehensive response to the panel's

recommendations, and make certain that the appropriate departments – Finance Canada and the Canada Revenue Agency (CRA) – work in close collaboration with one another throughout the entire process.

Sales tax harmonization

Harmonization simplifies the tax system. Instead of dealing with two different tax rates and tax bases as well as two separate tax administrations, businesses deal with only one tax rate and tax base, one set of rules and a single administration. Moreover, with a harmonized system, there are less compliance and reporting costs involved, making it easier for businesses to act in accordance with the rules.

Sales tax harmonization on a national scale would give Canada the strong tax advantage it seeks in all provinces – it would reduce costs and potentially improve Canada's productivity and competitiveness.

At present, there are five provinces that do not have a harmonized sales tax. CGA-Canada acknowledges the federal government's willingness to work with these five provinces to help facilitate the transition to provincial value-added sales taxes harmonized with the GST, as indicated in *The Budget Plan 2008*. This process ought to be fast-tracked.

Corporate tax rates

CGA-Canada notes through recent federal budgets and the 2007 Economic Statement in particular, the Government of Canada has made some good progress in reducing business taxes. We are pleased with the federal government's legislated reductions to the general corporate income tax rate to 15 per cent by 2012. We also applauded federal Finance Minister Jim Flaherty's announcement to reduce the small business income tax rate to 11 per cent in 2008, one year earlier than scheduled. These measures will help make Canada's tax regime more competitive, which bodes well for business growth, job creation and our country's productivity. That being said however, these measures will not make our tax system any simpler.

The idea of establishing a uniform corporate tax rate – where the general corporate income tax rate is on par with the small business income tax rate – deserves merit. A uniform corporate tax rate would eliminate rules that differentiate large and small business income, including the \$400,000 income threshold to be eligible for the deduction. It would also eliminate the necessity of differentiating between the GRIP (General Rate Income Pool) and the LRIP (Low Rate Income Pool) for purposes of calculating dividends eligible for the dividend tax credit. Standardizing the corporate tax rate would simplify the tax system, help attract foreign investment and encourage location in Canada, including head office operations of foreign multi-nationals.

The best way to achieve a single rate is to further reduce the corporate tax rate to a level that is equal to the small business tax rate. While CGA-Canada recognizes the country's fiscal situation is both volatile and tight at the moment, we nevertheless urge the federal government not to rule out the possibility of accelerating and deepening planned reductions to corporate taxes when and if feasible.

Simplified Methods

Both the *Income Tax Act* and *Excise Tax Act* include sections that authorize the use of simpler methods under certain circumstances. These are sometimes referred to as proxy methods and have been introduced in the past when the government has recognized that following normal procedures places an unduly heavy burden on small business. Instead of complying with highly complex provisions, some taxpayers are allowed to use easier methods in certain instances.

For example, instead of reporting total GST collected and deducting GST paid at 5 per cent, some businesses may simply remit a lower percentage of their sales to the Canada Revenue Agency. What this means is that a qualifying business would not claim any input tax credits, but would instead pay a lower percentage (than the current 5 per cent) than collected, based on sales. Similarly, in terms of the excessively complex automobile standby charge, two methods are available to calculate the benefit: one-half of the standby charge (subject to restrictions) or the simplified method with a prescribed fixed rate.

The federal government ought to consider introducing more simplified methods to areas other than the GST and/or automobile standby charges. Areas that are subject to frequent changes when audited or areas that are dependent on an analysis of historical events may be worthy of review. This matter ought to be referred to the newly-created expert panel for further consideration. The simplified method reduces the paperwork required and, therefore, the burden, and it is also consistent with the Government of Canada's Paperwork Burden Reduction Initiative which aims to reduce the costs of paperwork and regulatory compliance for small businesses.

Tackle the obvious

Drawing from recommendations advanced in CGA-Canada's submission to the *Advisory Panel on Canada's System of International Taxation*¹, there are a number of areas that are ripe for reform, including corporate reorganization rules, debt forgiveness rules and foreign investment entity rules and non-resident trust rules (including those provisions currently before the Senate of Canada under Bill C-10 – amendments to the *Income Tax Act*).

Corporate reorganization rules are among the most complex rules in the ITA and contain levels of subjective testing that lead to uncertainty in compliance, which therefore necessitate a cumbersome and expensive advance rulings application process. Existing corporate reorganization rules with all of the ancillary anti-avoidance measures ought to be reviewed. The same holds true for debt forgiveness rules, which have been adjusted time and time again, distorting the carrying values of assets and making it difficult to manage. In addition, the rules pertaining to foreign investment entities and non-resident trusts continue to attract much criticism as being excessive, unnecessary, complex and beyond administration. Moreover, other influential factors – namely, changes to the offshore investment environment and reductions in corporate taxation – highlight the need for careful consideration by a panel of experts.

¹ This submission is posted on CGA-Canada's website, http://www.cga-canada.org/en-ca/DiscussionPapers/ca_rep_submission_int'l_taxation2008-07.pdf

Changes in these areas would bring much-needed simplification to the tax system. Corporate filers would also be enabled to organize their business affairs with greater ease, certainty and confidence, allowing businesses to concentrate on what they do best – compete in the domestic and global marketplace.

Reviewing Canada's tax legislation with a view to identifying irrelevant or out of date provisions would be a relatively easy task for a panel of experts. Furthermore, streamlining or removing such unnecessary provisions would go a long way in simplifying and improving Canada's tax system.

Again, a number of examples fit the bill. For instance, with the Alternative Minimum Tax (AMT), if a taxpayer is assessed and pays AMT, he or she is entitled to a future refund equal to the amount of AMT paid in most cases. In other words, the AMT does not appear to increase government revenues on a long term basis or in any measurable way. It does, however – through its numerous pages of legislation – add to the complexity for taxpayers. This begs the question: what is the purpose of this tax? In addition, there are at least 52 classes for the Capital Cost Allowance (CCA), many of which are not relevant to the average business or taxpayer. CCA classes and rates should be reviewed so that they are realistic and reflect economic conditions as well as accounting criteria. The *Income Tax Act* is cluttered with provisions that specify dollar amounts that are out of touch with present day reality – principal residence rules and the threshold for capitalization of small equipment are two more cases in point. Canada's tax legislation ought to demonstrate currency and relevancy.

Manage the paper and administrative burden

Today's *Income Tax Act* is 260 times the size it was when it was first introduced in 1917. That is because a plethora of additions along with regulations have been made to the Act, while next to nothing has been removed since its inception.

The provincial government in British Columbia, through its Regulatory Reform Initiative, has set a zero-net increase target – that means for every new regulatory requirement introduced, requirements in other areas must be streamlined and simplified.

It would be worthwhile to consider applying the same logic to the *Income Tax Act* – every addition ought to be accompanied by a subtraction of some form, by removing or streamlining one rule, provision or section that is outdated or irrelevant.

CONCLUDING REMARKS

CGA-Canada appreciates the opportunity to provide its views on taxation priorities for Canada, as part of the federal budget process – a matter of importance to the Canadian public as a whole. We remain available for further comments or questions as we work together, with parliamentarians and government officials, in ensuring Canada has the tax system it needs for a prosperous and productive future.