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September 19, 2016

Mr. Paul Rochon
Deputy Minister
Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Mr. Rochon:

Re: Department of Finance Canada's Review of Federal Tax Expenditures

As a long-time advocate of tax reform, Chartered Professional Accountants of Canada (CPA Canada) fully supports the Government of Canada's initiative to undertake a review of federal tax expenditures. We also endorse the objective of the review, which aims to ensure that federal tax expenditures are fair, efficient and fiscally responsible – and to identify and eliminate poorly targeted and inefficient tax measures. In this letter, we are pleased to share our views and to recommend that the Department consult with the public on the interim findings of the review this fall before any final decisions are taken in Budget 2017.

We note that the goals of the federal tax expenditure review align with recommendations advanced by CPA Canada in pre-budget submissions to the House of Commons Standing Committee on Finance in both 2014 and 2015. Moreover, we are pleased to note that a panel of seven expert advisors – including Kevin Dancey, retired president and CEO of CPA Canada – has been appointed to assist the Department of Finance Canada as it conducts its expenditure review.

As you are aware, CPA Canada serves as the national and international voice for Canada's accounting profession. Representing more than 200,000 Canadian Chartered Professional Accountants working at home and abroad, CPA Canada is now the third largest accounting body in the world and one of the largest professional organizations in Canada. CPAs work in every sector of the economy, and are the business and accounting leaders that Canadian taxpayers count on to represent their interests with integrity and competence, and to help them comply with Canada's complex tax laws. CPA Canada also works collaboratively with the Government of Canada, including the Canada Revenue Agency and Finance Canada, with a view to improving the tax system for all Canadians.

Given our expertise and experience in tax policy and administration, CPA Canada believes it is critical that the perspectives of the accounting profession are considered in the federal tax expenditure review. For that reason, we are pleased to share our views and recommendations in relation to the federal tax expenditures review, as well as our suggestions for the government's consideration toward a broader, longer-term tax reform initiative.

Canada's tax system is a key lever for ensuring that our business environment remains competitive, for attracting talent and investment from around the world, and for achieving sustained economic growth and prosperity for all Canadians.

Tax expenditure review – an important step forward

Canada's *Income Tax Act* (ITA) has evolved from a few pages of general principles in 1917 to an intricate and complex patchwork of cumbersome rules governing a variety of circumstances and transactions, which has made it difficult to comprehend for even those who are tax professionals. As part of this evolution and growth, targeted tax preferences have been introduced at an increasing pace and are now a prominent feature of today's ITA.

In 1988, Canada adopted the approach of allowing tax credits instead of deductions for personal allowance. This change in tax policy was seen as a move to promote greater horizontal equity among taxpayers since credits have the same value to all taxable individuals irrespective of their income levels. Regardless of the intent, a number of criticisms have been directed towards tax credits in general by economists, policy analysts, academics, think tanks, national organizations and others. Some of these arguments include:

- Targeted tax measures are less economically efficient as broad-based tax reductions.
- Targeted tax measures lead to higher administrative costs as a result of increased requirements in record keeping, tracking and monitoring.
- Targeted tax measures are unfair, in that one specific group or activity is singled out for preferential treatment in comparison to other taxpayers who may perceive themselves to be, or are, in similar circumstances – creating a situation of "winners" and "losers".
- Targeted tax measures add layers of complexity to the tax code and can create loopholes in the system, increasing the likelihood of aggressive tax planning.
- Targeted tax measures do not consistently achieve their intended purposes and can have questionable results.

Two of Canada's most respected authorities on sound fiscal policy – the Parliamentary Budget Officer and the Auditor General of Canada – have also focused some attention on the way in which tax-based expenditures are managed by the Government of Canada.

In a June 2011 report, the Parliamentary Budget Officer (PBO) noted that the *Financial Administration Act* requires a review and evaluation of all government programs every five years; yet there is no comparable requirement for tax expenditures, which account for tens of billions of dollars annually. The PBO concluded, "*[p]arliamentarians may wish to consider establishing a process of review for existing tax expenditures similar to that provided for all other public expenditures.*"[1]

More recently, in an April 2015 report, the Auditor General of Canada found that information provided by the Department of Finance Canada on tax-based expenditures did not adequately support parliamentary oversight. In addition, the Auditor General noted that the Department of Finance Canada did not systematically evaluate all tax-based expenditures, nor publish evaluations on a general basis.

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[1] Office of the Parliamentary Budget Officer, *Federal Tax Expenditures: Use, Reporting and Review*, June 1, 2011. See: http://www.pbo-dpb.gc.ca/web/default/files/files/files/Publications/Tax_Expenditures_Note_EN.pdf

As a result, the Auditor General made three specific recommendations in relation to tax-based expenditures:

1. *To adequately support parliamentary oversight, the Department of Finance Canada should adopt improved reporting practices for tax-based expenditures to provide additional information, including cross-references of tax expenditures to direct program spending, so that readers can understand total government spending; and projected cost estimates in future years. Also, in order to support parliamentary oversight, the annual Tax Expenditures and Evaluations report should be tabled in Parliament.*

2. *The Department of Finance Canada should conduct systematic and ongoing prioritized evaluations of all tax-based expenditures, similar to what all departments and agencies are required to do for direct program spending. These evaluations should include assessing the measure's ongoing relevance and appropriateness; determining whether the tax system is the most effective and efficient way to meet policy objectives and deliver outcomes; and establishing whether to abolish, modify, replace, or retain the tax-based expenditure.*

3. *Similar to the reporting requirements for direct program spending evaluations, the Department should publish, in a timely manner, pertinent information for all tax-based expenditure programs that have been evaluated to facilitate consideration by parliamentarians and Canadians of the ongoing relevance and performance of tax-based expenditures.*[2]

While CPA Canada recognizes that the Department of Finance Canada has made efforts to improve the process governing tax-based expenditures, we wholeheartedly agree with, and have publicly endorsed, the recommendations made by the PBO and the Auditor General of Canada. Indeed, CPA Canada has made similar recommendations to the federal government, including that it:

- *Issue criteria to assess the effectiveness of tax credits on a regular basis to ensure their effectiveness in maintaining a fair, broad-based and efficient tax system.*
  (Pre-budget submission, August 2014)

- *Review all personal income tax credits and retain only those tax-based expenditures that have proven to be the most effective and efficient according to established systematic criteria, including costs and benefits.*
  (Pre-budget submission, August 2015/Winter 2016)

CPA Canada respectfully requests that the Department's current tax expenditure initiative address the concerns noted above, and bring an evidenced-based inclusive approach to effectively managing and evaluating federal tax expenditures.

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[2] Office of the Auditor General of Canada, 2015 Spring Reports of the Auditor General of Canada, Report 3 – Tax-Based Expenditures. See: http://www.oag-bvg.gc.ca/internet/English/parl_oag_201504_03_e_40349.html

An inclusive approach

CPA Canada submits that the Department of Finance Canada would be well-advised to consider an inclusive approach that canvasses a broad range of public perspectives before any decisions are made – as a matter of public interest.

It is likely that there are some tax-based expenditures which have been poorly targeted, inefficient, or have failed to achieve their intended purposes – the Children's Fitness and Arts Tax Credits might be such examples, as these credits were reduced this year and will be eliminated in 2017, due to 2016 budget decisions. It is equally possible, however, that there are other tax expenditures which have served individual Canadians and businesses well or are beneficial in other ways, and should be retained or enhanced. Some would argue that tax incentives that promote savings (Tax-Free Savings Account, Registered Retirement Savings Plan), encourage R&D in Canada (Scientific Research and Experimental Development Tax Credit) or assist small businesses, for example, all serve worthy goals. That is why a thorough review of all the federal tax expenditures is required. While we recognize that such a review may be beyond the mandate or capacity of the department and the appointed expert advisors, CPA Canada believes that, for the review to be truly effective, it should be comprehensive in its scope.

Given the vast number and wide array of tax exemptions, deductions and credits available to Canadians, along with their sizeable cost to the nation's fiscal framework, the current tax expenditure review is a significant initiative that involves all Canadians.

Therefore, CPA Canada believes there needs to be a process in place for a national dialogue, a public consultation during the tax expenditure review. The current process is department-driven and we understand that the findings may translate into direct budget decisions, with late-stage consultations to occur when draft legislation is released.

We note that the Prime Minister's mandate letters to his cabinet team, including the Minister of Finance, emphasize the importance of inclusiveness, collaboration and constructive dialogue with Canadians, civil society and stakeholders, including business.

In that spirit, CPA Canada recommends that a national consultation be launched early in the process, enabling all affected and interested stakeholders to take part and contribute input well in advance of the 2017 federal budget. We recommend that, as an interim measure, the Department of Finance Canada release its findings in mid-fall and set out a draft framework for legislative action that invites and encourages all Canadians to participate.

Canada needs a more comprehensive tax system review

The federal tax expenditure review is a step in the right direction, but CPA Canada believes this initiative falls short of the comprehensive review that is required.

There is a strong consensus that more needs to be done to improve Canada's tax system. As the *Income Tax Act* approaches its 100^{th} anniversary in 2017, it has become unduly complex over time, with excessive compliance and administrative costs. The Royal Commission on Taxation in 1966 was the most recent review, 50 years ago, and Canadian society and our economy have changed markedly since then.

Many prominent organizations have highlighted the adverse effects on Canada's economic productivity and prosperity that result from a complex and inefficient tax regime:

- In March 2016, a PwC study, commissioned by the Business Council of Canada, found that large corporations in Canada pay – or collect and remit – at least 68 different kinds of taxes to the three levels of government. According to the report, each of the 89 companies participating in this study employed 19 full-time-equivalent staff and spent $4 million each year, on average, to comply with Canadian tax regulations.[3]
- The World Economic Forum's Global Competitiveness Report 2015-2016 ranked tax rates and the complexity of tax regulations as two of the most problematic factors for doing business in Canada.[4]
- The Fraser Institute estimated that taxpayers and businesses spent up to $25 billion in 2011 to comply with Canada's tax code – representing 1.4 per cent of Canada's GDP. The report also estimated the government cost of tax administration (e.g., collecting taxes, maintaining records and managing appeals at the federal, provincial and municipal levels) to be $6.6 billion in 2011.[5]

Across Canada, several major national organizations, prominent economists and academics, and think tanks have endorsed a comprehensive review of Canada's tax system with a view to simplifying it and supporting economic growth. They include the Canadian Chamber of Commerce, the Business Council of Canada, the Canadian Taxpayers Federation, the C.D. Howe Institute and the Conference Board of Canada, to name a few.

In addition, the House of Commons Standing Committee on Finance ("Finance Committee") has, for the past four consecutive years, called on the federal government to explore ways to simplify the *Income Tax Act*. Of particular significance, in June 2016, the Finance Committee passed a motion to undertake *"a comprehensive review of the Income Tax Act and the Canadian tax system and prepare a report."* The Finance Committee's motion highlights that key issues such as *"tax complexity, tax fairness and the general effectiveness of the tax system are consistently cited by stakeholders and Canadians generally",* and recognizes that *"Canada requires a competitive tax system to foster a climate that propels innovation, job creation and overall long-term economic growth."*[6]

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[3] PwC, *Total Tax Contribution: Surveying Canada's leading enterprises*, March 2016. See: http://thebusinesscouncil.ca/wp-content/uploads/2016/03/Total-Tax-Contribution-2016-Surveying-Canadas-leading-enterprises.pdf

[4] World Economic Forum, *Global Competitiveness Report 2015-2016.* See: http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf

[5] Fraser Institute, *The Compliance and Administrative Costs of Taxation in Canada*, April 2013. See: https://www.fraserinstitute.org/sites/default/files/compliance-and-administrative-costs-of-taxation-in-canada-2013.pdf

[6] House of Commons Standing Committee on Finance, June 16, 2016. See: http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=e&Mode=1&Parl=42&Ses=1&DocId=8378566

In short, a top-to-bottom review of Canada's tax system is required, long overdue and well supported. Importantly, an all-encompassing systemic review is also consistent with the Government of Canada's stated commitment to *"to making sure that the tax system is as fair, efficient and simple as possible in order to support growth and the well-being of Canadians."*[7]

Guiding principles and desired outcomes

In CPA Canada's most recent pre-budget submission to the Finance Committee (Summer 2016), we make the following recommendations concerning the principles and outcomes that should guide a comprehensive tax review:

- **Keep the personal tax rates low, the tax base broad and ensure that inefficient or ineffective tax preferences are eliminated.** The impact of the new top tax rate of 33 per cent will need to be monitored, as the combined personal tax rate in some provinces now exceeds 50 per cent. Canada now has the third-highest top tax rate of all OECD countries.[8]

- **Keep corporate tax rates low** to maintain a competitive edge internationally, attract new investment and create jobs.

- **Consider changing the income tax/consumption tax mix** to bring it closer to OECD averages to improve Canada's tax competitiveness.

- **Do not tax personal savings** — particularly in view of the changes to the TFSA limit, Canada's high levels of household debt and its rapidly aging population that is saving for retirement.

- **Focus on a pro-growth approach** with measures that encourage innovation, productivity and prosperity.

- **Work with the provinces and territories** to facilitate a coordinated approach to tax administration that benefits all Canadians and recognizes there is only one taxpayer.

The need for tax reform is not just a domestic issue. A collaborative approach must be taken globally to ensure that national tax policies are completely in step with the evolving international business environment.

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[7] Finance Canada, *Review of Federal Tax Expenditures*, June 17, 2016. See: http://www.fin.gc.ca/access/tt-it/rfte-edff-eng.asp

[8] According to the OECD, one of the key tax policy principles for inclusive growth involves broadening the tax bases and removing tax expenditures that are not well-targeted at redistributive goals. The OECD also contends that raising marginal PIT and other marginal tax rates on high earners might not bring in much additional revenue. See: http://www.oecd-ilibrary.org/taxation/tax-design-for-inclusive-economic-growth_5jlv74ggk0g7-en

As you are aware, any review or reform initiative that seeks to improve a country's tax system must address multiple considerations and challenges. The appendix on page 8 lists some key sources from Canada and abroad that may be informative at a general level, and in considering some of the best practices of other countries for tax system reform.

CPA Canada, and the business and accounting professionals we serve, would welcome the opportunity to further discuss our key recommendation or any other issues relating to the current tax expenditure review, as well as the need for an all-encompassing, longer-term tax system review.

Thank you for your consideration.

Yours truly,

Gabe Hayos
Vice President, Taxation

Attachment

CC. Andrew Marsland, Senior Assistant Deputy Minister, Tax Policy Branch, Finance Canada
Brian Ernewein, General Director, Tax Policy Branch, Finance Canada

Appendix – Background material

Below we list some key sources that the Department of Finance Canada may find informative in determining its approach to comprehensive tax reform.

A Submission to the House of Commons Standing Committee on Finance (Summer 2016)
This brief for the Finance Committee sets out CPA Canada's recommendations for the 2017 budget. Among its recommendations, CPA Canada calls for budget measures that promote responsible fiscal management and deliver comprehensive tax reform.

Issue in Focus: The Need for Tax Simplification – A Challenge and an Opportunity
This 2011 publication from Certified General Accountants of Canada (CGA-Canada, a CPA Canada predecessor organization) provides an overview of the challenges associated with simplifying income tax and the reasons for tax complexity. The authors support tax simplification at both the personal and corporate level as necessary to increase taxpayer compliance rates and lower administration costs, as well as a way to contribute to a sustainable fiscal structure and overall economic growth.

Tax Simplification: Benefits and Political Challenges in a Canadian Context
This 2012 CGA-Canada publication summarizes discussions at a national stakeholder summit that brought together tax practitioners, public officials and other thought leaders. It frames the argument for tax simplification as an initiative that provides countless economic benefits and outlines key steps toward simplifying Canada's overly complex tax regime. The report concludes that tax simplification is in the best interests of taxpayers, businesses, governments and the Canadian economy. The report also puts forward national recommendations.

Moving on from the Tax Legislation Rewrite Projects: A Comparison of the New Zealand Tax Working Group/Generic Tax Policy Process and the United Kingdom Office of Tax Simplification
This 2013 article from Thomson-Reuters examines the New Zealand and United Kingdom efforts to simplify their respective tax systems and focuses on what lessons can be learned from these experiences that would increase the prospects for simplification.

Tax Design for Inclusive Economic Growth. OECD Taxation Working Papers No. 26, July 2016.
Drawing on recent developments in academic literature and in tax policies, this paper examines how the basic design features of countries' tax systems can be improved to better achieve inclusive economic growth.

Ten Tenets for a Better Tax System
This discussion paper prepared by the Institute of Chartered Accountants of England and Wales summarizes 10 key factors that should be addressed whenever major changes to tax law are considered.