

Intelligence MEMOS



From: John Oakey
To: Department of Finance Canada
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Re: **CANADA'S INCREASINGLY EXCESSIVE TAX COMPLIANCE DEMANDS**

Throughout my career, the *Income Tax Act* has grown increasingly complex – complicating even the simplest transactions.

This underscores the need for a thorough review of the Act, a sentiment shared by CPA Canada in our 2024 pre-budget submission, which recommended prioritizing a principled approach to tax policy and administration driven by purpose and vision. After all, simplicity, fairness, efficiency, and competitiveness are among the most basic principles of a good tax system.

Unfortunately, the federal government's recent approach to addressing specific tax issues has led to broad, complex rules. This has escalated compliance costs and administrative burdens, often involving excessive and needless reporting. While tax rules aim to achieve policy objectives, their design is as crucial as the objectives themselves. This must be acknowledged to avoid unintended consequences.

New, well-meaning tax regulations have resulted in substantial administrative challenges or unfairness to taxpayers inadvertently swept up by these rules, despite not being the intended policy targets.

For instance, trusts must now report beneficial ownership to prevent money laundering, financing of terrorism, and tax evasion. While the aim is clear, the broad scope of affected taxpayers (including bare trusts) with limited narrow exceptions, like the \$50,000 (asset specific) de minimis threshold, create excessive burdens. Even for the tax collectors. The CRA was recently compelled to exempt bare trusts from the 2023 reporting obligation due to its inability to administer the breadth of bare trusts.

Meanwhile, the Underused Housing Tax, aimed at addressing housing demand by focusing on vacant foreign-owned residential properties is another casualty as the negligible number of such properties contrasts starkly with actual housing shortage. Poorly executed, this tax led to extensive reporting by Canadians who indirectly owned their residential property through a corporation, partnership or trust, necessitating deadline extensions. CPA Canada advocated for the exclusion of Canadians with indirect ownership, which eventually resulted in legislative changes.

Mandatory Disclosure Rules or MDRs are another example. The broad definition of “avoidance transaction” encompasses regular tax planning, causing significant anxiety over harsh non-compliance penalties. Despite being guided by three generic hallmarks, the rules' vagueness leads to high administrative and compliance costs, pushing professionals to report extensively to avoid penalties. Given that vagueness, the CRA was forced to produce its own interpretive guidance to make the regime workable.

Proposed General Anti-Avoidance Rule amendments also bring uncertainty, particularly around transactions significantly lacking economic substance. This ambiguity will likely compel over-reporting by taxpayers and practitioners seeking to sidestep possible penalties.

This ambiguity is increased when the government ignores its own economic substance test to accomplish its own objectives as with the deliberate tax revenue generation associated with the increase in the capital gains inclusion rate. Only two weeks after the budget, the CRA's Income Tax Rulings Directorate said the “crystallization of an accrued gain, solely as a means of ensuring access to the current inclusion rate, would not, in itself, be subject to GAAR.” With the potential lack of economic substance in crystallization transactions, this statement may actually create further ambiguity with the general application of GAAR.

Finally, the revised Alternative Minimum Tax (AMT) regime disrupts fundamental tax principles with a 100-percent capital gains inclusion rate and only half the allowable capital loss deductions. This change can unfairly increase tax burdens during fluctuating investment years, contradicting the core concept of offsetting gains with losses.

These examples likely won't surprise tax practitioners familiar with applying these rules. However, the increasing complexity of the *Income Tax Act* and regulations is reaching a point where even seasoned practitioners may struggle to navigate it with confidence.

The federal government must minimize its political interference with our tax system to accomplish a myriad objectives while enforcing extensive reporting mandates without well-defined parameters. Further, our legislative drafters need to be reminded of the basic tax principles: Certainty, simplicity, effectiveness and fairness, efficiency, horizontal and vertical equity, neutrality, and flexibility. Legislative drafts should urgently focus on accuracy and specificity in reporting requirements, rather than resorting to overly broad regulations.

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