



HOUSE OF COMMONS
CANADA

CHAPTER 3, "INCOME TAX LEGISLATION," OF
THE FALL 2009 REPORT OF THE AUDITOR
GENERAL OF CANADA

**Report of the Standing Committee on
Public Accounts**

Hon. Shawn Murphy, **MP**
Chair

APRIL 2010

40th PARLIAMENT, 3rd SESSION



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STANDING COMMITTEE ON PUBLIC ACCOUNTS

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THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

has the honour to present its

TWELFTH REPORT

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied Chapter 3, "Income Tax Legislation," of the Fall 2009 Report of the Auditor General of Canada and has agreed to report the following:

INTRODUCTION

Canada's tax system relies on taxpayers to self-assess and pay the income taxes they owe. For our system to work, tax administrators and taxpayers must be able to have a clear understanding of the requirements of the *Income Tax Act* (the *Act*) and its associated regulations. Uncertainty about the application of tax provisions may arise due to unclear language in the legislation, court decisions, or new forms of business transactions. In order to improve the clarity of tax provisions, it may be necessary from time to time to make technical amendments to the *Act*.

The Department of Finance Canada (the Department) is responsible for evaluating federal tax policy and advising the Minister of Finance on the need for, and the drafting of, technical amendments to income tax legislation. The Canada Revenue Agency (the Agency) is responsible for administering the *Income Tax Act*, its regulations and related statutes, and for collecting taxes. The Agency provides advice and guidance on the interpretation and application of the *Act* to taxpayers and its tax auditors.

In fall 2009, the Office of the Auditor General (OAG) released a performance audit that focused on the Department of Finance Canada's and the Canada Revenue Agency's activities to identify and develop legislative amendments to correct technical deficiencies in the *Income Tax Act*.¹ It also focused on the Agency's activities to provide guidance to taxpayers and tax auditors on how to interpret and apply tax law.

As the Public Accounts Committee (the Committee) believes that it is very important to maintain clarity in our tax system, the Committee held a meeting on this audit on 23 March 2010.² From the Office of the Auditor General, the Committee met with John Rossetti, Assistant Auditor General and Vicki Plant, Principal. From the Department of Finance Canada, the Committee met with: Michael Horgan, Deputy Minister; Louise Levonian, Senior Assistant Deputy Minister, Tax Policy Branch; and Brian Ernewein, General Director, Tax Policy Branch. From the Canada Revenue

¹ Auditor General of Canada, Fall 2009 Report, *Chapter 3 – Income Tax Legislation*.

² House of Commons Standing Committee on Public Accounts, 40th Parliament, 3rd Session, Meeting 4.

Agency, the Committee met with: Linda Lizotte-MacPherson, Commissioner; and Brian McCauley, Assistant Commissioner, Legislative Policy and Regulatory Affairs Branch.

OUTSTANDING TECHNICAL AMENDMENTS – DEPARTMENT OF FINANCE

One of the roles of the Tax Legislation Division of the Department of Finance is to develop technical changes to the *Income Tax Act* in order to correct anomalies that arise after the original tax measure was passed and to correct consequences that were not intended. Legislative clarity is important in order for taxpayers to correctly calculate their taxes. When the intent of the legislation is not clear, taxpayers may face higher costs to obtain professional advice, may be more willing to use aggressive tax plans, and may need to re-file a tax return at an additional cost. This situation can also lead to higher costs for the Canada Revenue Agency to provide additional guidance and interpretation to taxpayers and tax auditors, as well as increased administrative costs to obtain waivers from taxpayers to extend the limitation period for audit reassessments.

The OAG examined whether the Department of Finance had a well-managed process in place to comprehensively record, track, and prioritize legislative issues, and whether it used this process to select issues for draft technical amendments. The audit found that the Department has an electronic database, but it is not used consistently. Instead, the Department relies on basic, people-dependant processes. Also, the Department has no formal criteria for identifying priority legislative amendments. Officials from the Department told the Committee that they have prepared a consolidated inventory of outstanding technical changes and are updating their existing electronic database to reflect this. The Department has also commenced a project to acquire a new electronic database for tracking technical amendments and expects to have all existing data transferred to the new database by 31 March 2011. The Department has established the following criteria to prioritize outstanding technical changes: the amount of revenue, if any, involved, the number of taxpayers affected and the impact on them, and whether issues are created with respect to the administration of the tax system.

The audit also found that the list of outstanding technical amendments to the *Income Tax Act* has been growing as no income tax technical bill has been passed by Parliament since 2001. At the time of the audit, there was a backlog of at least 400 technical amendments, including 250 “comfort letters.”³ Some of these technical amendments were included in a bill that was first released in 2002, and subsequently re-released several times, but has not been passed.

Officials from the Department told the Committee that when they discover things that will result in a revenue loss for the government, they try to take action as soon as possible. The Department puts out a press release indicating that legislation will be proposed to prevent an identified problem and then hope that Parliament will agree and pass legislation to this effect. One of the risks associated with not having technical amendments passed in a timely manner is that tax returns become statute barred after three years for individuals and four years for large corporations. In other words, if the changes proposed in a press release or a comfort letter are not made within three or four years, then the Canada Revenue Agency will not be able to go back and re-examine tax returns prior to this time and issue a reassessment. The Agency may try to obtain a waiver to keep the tax year open for a reassessment, but this will only be possible in select cases. Comfort letters are at best a stop-gap measure and are intended to be used in the short term. Ultimately, technical issues can only be resolved by legislation passed by Parliament.

To be fair to the Department, as mentioned earlier, a bill making technical amendments to the *Income Tax Act* has been introduced several times since 2002 but has not been passed. Parliament needs to share responsibility for ensuring that technical amendments are passed in a timely manner after they are introduced. The Department’s responsibility is to put the government in a position to be able to table technical bills; after that, it is up to Parliament to ensure that they are passed.

³ These letters are usually sent to taxpayers when the tax result is not the one intended by the law. The Department promises in the letters to recommend to the Minister that a minor, non-policy legislative change be made to resolve the issue in question.

Nonetheless, there are a number of things that the Department can do to try to aid the process. It is more likely that a bill containing only technical amendments will pass quicker than one that includes potentially controversial policy changes, as policy issues often lead to greater scrutiny and discussion during parliamentary committee review. The previous technical amendments bill also included policy changes regarding foreign investment entities and non-resident trusts. Thus, the Committee recommends:

RECOMMENDATION 1

That the Department of Finance Canada facilitate the elimination of the backlog by ensuring that bills making technical amendments to the *Income Tax Act* only relate to technical tax matters.

Over the past several years, the Department has not released for comment any draft legislative proposals. Officials told the Committee that they have avoided doing this because they are concerned that bringing forward draft technical amendments when a previous technical bill is still pending before Parliament could create confusion and complexity from having multiple bills or proposals to amend the same provisions of the *Act*. In its response to the OAG's recommendation, the Department states that it, "agrees to consider whether there are circumstances where it would be appropriate to bring forward for consideration a subsequent draft technical amendments package, notwithstanding the fact that the previous technical bill had not yet been adopted by Parliament."⁴ The Committee does not feel that this is strong enough. If the Department is to be serious about reducing the backlog of technical amendments, then it cannot simply wait for bills to pass before releasing further proposed amendments for comment. The Department should be able to take adequate measures to either minimize confusion or mitigate its effects. The Committee recommends:

RECOMMENDATION 2

That the Department of Finance Canada not wait until technical amendments bills are passed by Parliament before releasing further proposed amendments to the *Income Tax Act* for comment.

⁴ Chapter 3, Response to recommendation 3.40.

Officials from the Department told the Committee that they are hoping to have a technical bill ready for the government's review within the next couple of months. They are also considering releasing smaller packages of technical amendments on a regular basis. The Committee believes that this is a good strategy, as smaller bills are less likely to be controversial and get caught up in extensive committee hearings. According to the OAG, the government has stated that an annual technical bill of routine housekeeping amendments to the *Act* is desirable. The Committee agrees because an annual bill would be smaller in size, help prevent the build-up of a backlog of amendments, keep the *Act* up to date with changing business practices, and minimize the likelihood that issues raised by comfort letters will become statute-barred. Although, officials told the Committee that they would not be in a position to propose annual technical bills until the end of 2011. The Committee recommends:

RECOMMENDATION 3

That once the current backlog of technical amendments is passed, the Department of Finance Canada should prepare annual technical amendments bills for consideration by Parliament.

The Committee is concerned that there may be outstanding technical changes needed in other legislation. In the past, the government has introduced these changes through a Miscellaneous Statute Law Amendment Act bill. However, the last time this occurred was in 2001. The Committee encourages the government to use this mechanism more frequently to ensure that technical amendments to various acts are made in a timely manner.

PROVIDING LEGISLATIVE INPUT AND GUIDANCE – CANADA REVENUE AGENCY

The Canada Revenue Agency provides guidance to taxpayers and tax auditors on how to apply and interpret the *Income Tax Act*. It also assists the Department of Finance in identifying and developing technical changes that may be needed in the legislation.

The audit examined whether the Canada Revenue Agency maintains a complete list of legislative issues that it has identified as needing technical amendments, and whether it communicates these to the Department of Finance. The audit found that the Agency does inform the Department about issues that it thinks need legislative amendments, sending about 20 letters to the Department last year. However, these issues are not systematically tracked and monitored within the Agency. The OAG recommended that the Agency create an electronic database to help validate, analyze, and prioritize technical issues that should be referred to the Department. The Agency agreed to do so, and officials told the Committee that a system has been in place since December 2009.

The audit examined guidance provided by the Agency when the interpretation and application of tax legislation may be unclear. The Agency provides advance income tax rulings, for a fee, and technical interpretations of income tax law to taxpayers. The Agency has met its service standard for technical interpretations, but has not met its standard for advance income tax rulings.

The OAG recommended that the Agency should develop more concrete plans to meet its target times for issuing advance income tax rulings. In its response, the Agency stated that it would “formally evaluate these performance standards to ensure they adequately reflect the time needed for issuing advance rulings, given the increased complexity of these cases.”⁵ Officials from the Agency clarified this response at the hearing by stating that they will be looking for efficiencies in the way that they manage their files. The Agency will also engage in consultations with tax practitioners to determine what their expectations are and whether the Agency needs to have a couple of standards: one for more straightforward rulings and another for more complex rulings. The Agency will be considering these issues over the coming months.

For the majority of taxpayers, the explanations of tax law provided in the Agency’s tax guides and pamphlets are sufficient. To assist tax preparers with more

⁵ Chapter 3, Response to recommendation 3.60.

complicated matters, the Agency provides Income Tax Information Bulletins, which outline the Agency's technical interpretation and position on certain provisions of income tax law. However, the audit noted that some of the bulletins are not up to date, and the Agency has no formal process to monitor whether bulletins are still current or to decide whether they need to be withdrawn or revised. The Agency also does not communicate if part of a bulletin is no longer correct. This means that there is a risk that tax preparers could be providing taxpayers with incorrect advice to their clients, which in turn could lead to reassessments for more tax owed.

The OAG recommended that the Agency should improve the information it provides to users about specific paragraphs in the bulletins that are no longer accurate. The Agency responded by noting that, "the Agency may opt to cancel its inventory of Interpretation Bulletins. To that end, the Agency will evaluate this option during 2010 and ensure practitioners are consulted and aware of any subsequent plan of action to either update these bulletins or cancel them."⁶ At the hearing, the Agency's Commissioner, Linda Lizotte-Macpherson, clarified that, "we want to take the time to consult practitioners and other users as to the value and utility of income tax interpretation bulletins. Their input will help us determine whether there are more efficient ways in which we could deliver the same quality of information to them."⁷ While the Agency has not taken any decisions, the Committee would like to note that it will be important that the Agency continues to provide tax preparers with up-to-date authoritative technical interpretations of tax legislation in some form or other; this is not currently provided in the Agency's other publications, such as pamphlets, guides, and tax return packages.

Prior to the hearing, the Agency provided the Committee with an action plan of how it intends to address the OAG's recommendations. John Rossetti, Assistant Auditor General, indicated that the hearing and the action plan had helped to clarify the Agency's intentions. He said:

⁶ Chapter 3, Response to recommendation 3.69.

⁷ Meeting 4, 9:10.

The responses as printed in the chapter were good but possibly not as positive as I was hoping. However, in reading the opening remarks from the Commissioner and looking at their action plan they've really addressed the key aspects of our recommendations. I'm optimistic that they will be implemented as we had actually recommended.⁸

As some of the Agency's decisions and subsequent actions are dependent upon consultations with taxpayers, practitioners, academics and other stakeholders, it will take some time for the action plan to be implemented. The Committee would like further information about what decisions the Agency will take with respect to its performance standards and information bulletins, so it recommends:

RECOMMENDATION 4

That the Canada Revenue Agency provide by 31 March 2011 a progress report to the Public Accounts Committee on actions taken to address the recommendations contained in Chapter 3 of the Auditor General's Fall 2009 Report.

CONCLUSION

The integrity of Canada's income tax system depends upon taxpayers and tax auditors having a clear understanding of the requirements of the *Income Tax Act* and its associated regulations. A lack of clarity can lead to increased costs for taxpayers who may need to seek out professional advice and for the Canada Revenue Agency when it administers the tax system. While the Department of Finance keeps track of and prepares legislative amendments that would bring greater clarity to the *Act*, it has not had recent success in having its proposed amendments passed by Parliament. Nonetheless, the Committee believes that there are actions the Department could take to help ensure that technical amendment bills are passed in a timely manner, such as, proposing technical amendment bills that only relate to technical income tax matters, releasing proposed amendments for comment before pending bills are passed, and releasing annual technical bills for consideration by Parliament. The Committee hopes that this will help eliminate the backlog of technical amendments, and if an annual

⁸ Meeting 4, 9:50.

technical bill becomes the norm, parliamentarians may become predisposed to passing these bills quickly.

The Canada Revenue Agency has committed to undertaking a number of actions to improve its tracking of legislative issues that require amendments, to examine its service standards for advance income tax rulings, and to consider how best to provide up-to-date technical interpretations to taxpayers. The Committee, however, agrees with the OAG—it is not enough to have a good plan; implementation of the plan is key. The Committee will be monitoring the progress of the Agency to ensure that it addresses these issues in a satisfactory manner.

The Committee hopes that its hearing and this report will help spur the Department and the Agency to make progress in ensuring that Canada's income tax legislation is clearly understood and is kept up-to-date.

APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
<u>40th Parliament, 3rd Session</u>		
Canada Revenue Agency	2010/03/23	4
Linda Lizotte-MacPherson, Commissioner		
Brian McCauley, Assistant Commissioner Legislative Policy and Regulatory Affairs Branch		
Department of Finance		
Brian Ernewein, General Director Tax Policy Branch		
Michael Horgan, Deputy Minister		
Louise Levonian, Senior Assistant Deputy Minister Tax Policy Branch		
Office of the Auditor General of Canada		
Vicki Plant, Principal		
John Rossetti, Assistant Auditor General		

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (40th Parliament, 3rd Session: [Meetings Nos. 4, 7 and 9](#)) is tabled.

Respectfully submitted,

Hon. Shawn Murphy, MP

Chair