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CANADA

**CHAPTER 3, AGGRESSIVE TAX PLANNING, OF
THE SPRING 2014 REPORT OF THE AUDITOR
GENERAL OF CANADA**

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

**David Christopherson
Chair**

FEBRUARY 2015

41st PARLIAMENT, SECOND SESSION

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THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

has the honour to present its

THIRTEENTH REPORT

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied Chapter 3, Aggressive Tax Planning, of the Spring 2014 Report of the Auditor General of Canada and has agreed to report the following:

CHAPTER 3: AGGRESSIVE TAX PLANNING

INTRODUCTION

Many taxpayers, including individuals, corporations and trusts, use tax planning strategies to reduce the amount of tax they owe to the government. In fact, the government encourages taxpayers to take advantage of legitimate tax savings opportunities. When tax planning reduces taxes in a way that is inconsistent with the overall spirit of the law, the arrangements are referred to as tax avoidance. Tax evasion, on the other hand, typically involves deliberately ignoring a specific part of the law with an intent to deceive; for example, taxpayers may under-report taxable receipts or claim expenses that are overstated, or they may attempt to evade taxes by refusing to comply with legislated reporting requirements. While tax evasion is a criminal offence under Canadian tax law, the Canada Revenue Agency (CRA) seeks to restrict the right of taxpayers to use tax avoidance strategies through the General Anti-Avoidance Rule (GAAR), which was added to the *Income Tax Act* (ITA) in 1988. The GAAR may be applied to tax plans that the CRA considers to be aggressive, that is, tax plans that are abusive in nature, where the primary purpose is to avoid the payment of required taxes. These plans may respect the letter, but not the object and spirit of the ITA.

The CRA is responsible for administering and ensuring compliance with Canada's tax laws. It has identified aggressive tax planning (ATP) as one of the highest risks to its mandate of ensuring that taxpayers meet their compliance obligations. Through its Compliance Programs Branch, the CRA administers the ATP program to:

- identify and address emerging tax avoidance issues, arrangements and products;
- promote voluntary compliance with Canada's tax laws; and
- apply, when warranted, the GAAR to a situation of ATP, which may result in the denial of the resulting tax benefit.

The Department of Finance Canada is responsible for developing and evaluating federal tax policy and for drafting tax legislation. The Department's Tax Policy Branch relies partly on the CRA to identify ATP and to prioritize issues that may require legislative change.

In its Spring 2014 Report, the Office of the Auditor General of Canada (OAG) released a performance audit that examined whether:

- the CRA has tools and processes in place to detect and correct non-compliance with the ITA and to deter the use of ATP; and

- the Department of Finance Canada has processes in place to provide timely analysis and draft legislation to address ATP issues identified by the CRA.¹
- To conduct its audit, the OAG examined four types of ATP:
- offshore insurance;
- registered retirement savings plan (RRSP) strips;
- stock dividend value shift; and
- tech wrecks.

The House of Commons Standing Committee on Public Accounts (the Committee) held a hearing on this audit on 11 December 2014.² From the OAG, the Committee met with Michael Ferguson, Auditor General of Canada, and Vicki Plant, Principal. From the CRA, the Committee met with Ted Gallivan, Deputy Assistant Commissioner, Compliance Programs Branch, and Lisa Anawati, Director General, International and Large Business Directorate, Compliance Programs Branch. The Department of Finance Canada was represented by Brian Ernewein, General Director, Tax Policy Branch, and Alexandra MacLean, Director, Tax Legislation, Tax Policy Branch.

DETECTING AND CORRECTING NON-COMPLIANCE

A. Detecting Cases of ATP

ATP often involves complex transactions and, according to the OAG, the CRA needs to ensure that a systematic process is in place to detect cases of high-risk ATP files. Through its International and Large Business Directorate's National Risk Assessment Model (NRAM), the CRA assesses large businesses annually to identify situations where there is a high risk of ATP and non-compliance with the ITA.

Michael Ferguson, Auditor General of Canada, told the Committee that, "[the CRA] has a number of ways to detect aggressive tax plans, such as through risk-based audits, referrals, voluntary disclosures, from informant leads, and from publicly available information, such as on the Internet. However, the agency has not fully evaluated whether it is able to detect high-risk business files."³ While the NRAM process had resulted in the

1 Auditor General of Canada, "Chapter 3: Aggressive Tax Planning," Spring 2014 Report of the Auditor General of Canada, Ottawa, 2014.

2 House of Commons Standing Committee on Public Accounts, Evidence, 2nd Session, 41st Parliament, 11 December 2014, Meeting 43.

3 Ibid., 1535.

development of indicators to assist auditors in detecting cases of ATP, the OAG found that the CRA had not finalized its evaluation of the effectiveness of its NRAM process.⁴ Without this evaluation, the CRA cannot be certain that high-risk cases are being identified and selected for follow-up. Consequently, the OAG recommended that the CRA complete the testing of the NRAM process.⁵

Ted Gallivan, Deputy Assistant Commissioner at the CRA, told the Committee that the CRA plans to test the NRAM during the 2015–2016 fiscal year.⁶ The CRA will be doing a comparison between what the NRAM risk indicators specify and the actual results from audits. As the model incorporates roughly 90 factors, or algorithms, the CRA will be examining whether each factor is predictive of the risk around a tax file.⁷ Mr. Gallivan also noted that the CRA is in the process of automating the system to allow auditors to view risk assessments graphically.⁸

B. Correcting Non-compliance

When a potential case of ATP is identified, the CRA first applies any technical and/or anti-avoidance provisions of the ITA that are appropriate. In the absence of any such provisions, the CRA – in collaboration with the Department of Finance Canada and the Department of Justice Canada as members of the GAAR Committee – determines whether the GAAR applies and, where applicable, conducts a reassessment.

The OAG indicated that all files in relation to the four types of ATP it examined were referred to the GAAR Committee; it also noted examples where the CRA has had success in correcting non-compliance.⁹ However, the OAG found that of the decisions it examined, the GAAR Committee had not documented one third of GAAR decisions.¹⁰ Since 1998, 54 GAAR cases have been litigated in the courts, and the CRA has been successful in 28 of those cases.¹¹

C. Training of Auditors

Since the CRA relies, in part, on field auditors to detect cases of ATP, the OAG indicated that the CRA needs to ensure that it provides sufficient training to ATP

4 Auditor General of Canada, Chapter 3, para. 3.20.

5 Ibid., para. 3.21.

6 Meeting 43, 1540.

7 Ibid., 1615.

8 Ibid., 1555.

9 Auditor General of Canada, Chapter 3, para. 3.24.

10 Ibid., para. 3.26.

11 Ibid., para. 3.28.

auditors.¹² The OAG found that the CRA provided adequate information to ATP auditors through technical news bulletins, information sessions and webinars. Also, the CRA had a formal learning path for ATP auditors. However, the OAG found that it could not assess the CRA's provision of training due to inaccurate or incomplete employee information and computer system limitations.¹³ The OAG recommended that the CRA monitor the progress of ATP auditors against their learning plan and provide training where needed.¹⁴

Mr. Gallivan informed the Committee that a training framework has been developed and its full implementation will be completed by 31 March 2015.¹⁵ He noted that there are three key questions with respect to training, "First, is the training that's supposed to be offered actually offered? Second, are the auditors actually taking the training? Third, what is the assessment of the result of that training? In other words, is the learning being ingrained in the performance?"¹⁶ Lisa Anawati, Director General at the CRA, told the Committee that the training framework will be applied not just to the ATP program but to the rest of the CRA's international and large business courses.¹⁷

DETERRING AGGRESSIVE TAX PLANNING

The OAG examined whether the CRA deters taxpayers from using ATP, and found that the CRA publishes news releases and creates awareness of its views on ATP among associations of tax professionals.¹⁸

The CRA also seeks to inform taxpayers of legitimate tax savings opportunities. Mr. Gallivan described the CRA's communication efforts as follows:

The agency has put a lot of effort into its electronic service and web services to help taxpayers take advantage of the credits that are available to them. We've gotten into webinars and almost a "taxTube" type of approach with videos. We've developed a community income tax volunteer program to reach out to some of the more vulnerable Canadians and make sure they're aware of the benefits they're entitled to. There's very much a promotion and marketing type of approach.¹⁹

Since third parties, such as tax preparers, advisers and promoters, can play a role in ATP, the CRA applies penalties on third parties through its Third-Party Penalty Review

12 Ibid., para. 3.29.

13 Ibid., para. 3.30.

14 Ibid., para. 3.33.

15 Meeting 43, 1540.

16 Meeting 43, 1550.

17 Meeting 43, 1550.

18 Auditor General of Canada, Chapter 3, para. 3.34.

19 Meeting 43, 1620.

Committee. From 2009–2010 to 2012–2013, the CRA referred 118 cases to this Committee, and penalties were applied in 48 cases, for a total value of penalties of \$63.3 million and a median penalty of \$440,000. According to the OAG, while it is not possible to know the extent to which penalties were an effective deterrent, their use probably influenced the behaviour of third parties with respect to ATP.²⁰

When asked about the responsibility of boards of directors for ATP, Mr. Gallivan observed that the CRA prefers to provide feedback. He said, “When the risk level of a company is determined, especially if it is a high risk, we officially meet with its board of directors or its representatives and explain the situation.”²¹ Brian Ernewein, General Director at the Department of Finance Canada, explained that large corporations retain very expensive legal advice to ensure that they are operating within the limits of the law. Additionally, corporations may pay low taxes due to tax incentives, such as loss carry-forwards, foreign income that is not subject to tax or inter-corporate dividends.²² He also noted that the Organization for Economic Cooperation and Development and G-20 countries are trying “to develop proposals to constrain [tax] base erosion and profit shifting, the sort of tax minimization that happens internationally.”²³ Mr. Ernewein commented that there are criminal sanctions for those who evade taxes, as well as for those who aid and abet the evasion of taxes.²⁴

MEASURING PERFORMANCE

The OAG examined whether the CRA measures the performance of its ATP program. The CRA has three main performance indicators for the ATP program: staff salary utilization, tax earned by audit (TEBA) and quality of file assessments.²⁵

With respect to staff salary utilization, in 2012–2013, the CRA spent about 89% of budgeted salaries, compared to its target of at least 90%.²⁶ The CRA met its TEBA target in 2010–2011 and in 2011–2012. The target was substantially increased in 2012–2013 and was not met.²⁷ The OAG noted that the TEBA can decrease if the amounts disclosed voluntarily increase, deterrence actions are effective or legislative changes result in fewer reassessments. The OAG concluded that this indicator does not provide a complete

20 Ibid., para. 3.37.

21 Meeting 43, 1625.

22 Meeting 43, 1625.

23 Ibid.

24 Ibid.

25 Auditor General of Canada, Chapter 3, para. 3.38.

26 Ibid., para. 3.40.

27 Ibid., para. 3.43.

assessment of the ATP program's long-term results.²⁸ It noted that the CRA is currently taking steps to develop better indicators²⁹ and recommended that a re-evaluation of performance measures be completed.³⁰

According to Mr. Gallivan, the CRA is committed to developing a list of relevant performance measures by 31 March 2015.³¹ With respect to the TEBA indicator, Mr. Gallivan said that it can provide a sense of the economic impact and efficiency of audits, for example, the TEBA increased from \$1.2 billion in 2012–2013 to \$1.7 billion in 2013–2014. Nonetheless, the CRA is working hard to develop other indicators, “because at some point we would like [the] TEBA to go down. That would tell us that we are being strategically successful.”³² An increase in the TEBA indicates that the CRA is being operationally successful, but over time the CRA would like to reduce ATP practices and thereby lower the TEBA.³³

The OAG also observed that the CRA's review of the quality of file assessments identified deficiencies in 11% of ATP files completed in 2010–2011. A review in 2013 produced similar findings. In response, the CRA implemented additional quality controls.³⁴

AMENDING LEGISLATION

The OAG examined the process followed by the CRA to identify situations of ATP that could be addressed through legislative changes and to submit timely requests to the Department of Finance Canada. It also examined how the Department handles these submissions and recommends legislative changes.

Ms. Anawati described how the CRA identifies new and emerging ATP schemes.³⁵ The CRA has a centre of expertise for ATP, which conducts data mining of tax returns and analyzes various forms of business intelligence. Auditors across the country may refer issues to the centre of expertise, and referrals may also come from the tax rulings department. Once a scheme has been identified, the CRA conducts test audits to determine whether the scheme is ATP. If it is considered to be ATP, the CRA will refer the matter to the GAAR Committee, and if a potential tax loophole is identified, the CRA will inform the Department of Finance Canada of its findings.

28 Ibid., para. 3.44.

29 Ibid., para. 3.45.

30 Ibid, para. 3.46.

31 Meeting 43, 1540.

32 Ibid., 1630.

33 Ibid.

34 Auditor General of Canada, Chapter 3, paras. 3.49 and 3.50.

35 Meeting 43, 1635.

The OAG noted two examples, RRSP strips and tech wrecks, where the CRA studied the issues and made submissions to the Department of Finance Canada, which were followed by legislative changes announced in federal budgets to stop the use of these ATP strategies.³⁶

The OAG sought to examine the work undertaken by the Department of Finance Canada when it considers the CRA's submission of priority issues. The OAG was unable to determine whether the Department had followed its processes for analyzing the CRA's submissions in a timely manner because the Department said that this information constitutes a Cabinet confidence and was outside the OAG's access to information entitlements outlined in existing orders-in-council.³⁷ Nonetheless, Mr. Ferguson observed that, "We were able to see that most of the requests from the agency in the three years under audit were addressed by the 2011 to 2013 federal budgets."³⁸

Mr. Ferguson indicated that the OAG has a protocol in place that allows it to communicate with deputy ministers and the Privy Council Office (PCO) about the OAG's ability to access information held by departments.³⁹ The OAG is undertaking discussions with the PCO to see if the protocol can be strengthened. Mr. Ferguson described how an improved protocol could work, "What I'm saying is that in future cases some of this type of analysis could be done and documented in a way that is outside the cabinet confidence documents so we would have access to that type of information."⁴⁰

As the Committee would like to monitor the OAG's progress in strengthening its protocol, it recommends:

RECOMMENDATION 1

That, by 31 May 2015, the Privy Council Office update the Standing Committee on Public Accounts on its discussions with the Office of the Auditor General regarding its protocol for accessing information held by departments.

PROGRESS REPORT

The CRA agreed with all of the OAG's recommendations and submitted an action plan to the Committee. Mr. Ferguson commented on the plan, stating, "We received a

36 Auditor General of Canada, Chapter 3, paras. 3.54 and 3.55.

37 Ibid., para. 3.59.

38 Meeting 43, 1535.

39 Ibid., 1550.

40 Ibid.

copy of the action plan the agency submitted to the committee and found it consistent with our recommendations.”⁴¹ As the Committee would like to ensure that the CRA makes progress in addressing the OAG’s recommendations, it recommends:

RECOMMENDATION 2

That, by 31 May 2015, the Canada Revenue Agency provide the Standing Committee on Public Accounts with a report outlining its progress in implementing the Office of the Auditor General’s recommendations in Chapter 3 of the Spring 2014 Report.

CONCLUSION

In order to maintain confidence in the tax system, it is important that the CRA ensure that taxpayers comply with their tax obligations. While using legitimate tax savings is encouraged, engaging in strategies that contravene the object and spirit of the *Income Tax Act* are not acceptable, and the CRA must take steps to counteract ATP. Through its ATP program, the CRA seeks to detect the use of known ATP strategies, identify emerging ATP strategies, correct ATP non-compliance and deter taxpayers from using ATP. Mr. Gallivan told the Committee that since 2006, the ATP program has undertaken approximately 8,600 audits yielding \$5.6 billion in additional revenue, which is an average of \$650,000 per audit.⁴²

Mr. Ferguson noted the audit’s overall conclusion of the CRA’s ATP program, stating, “We found that the Canada Revenue Agency has an adequate program to detect, correct and deter non-compliance of certain tax schemes.”⁴³

The CRA has put in place a training plan for auditors, as well as performance measures to monitor the ATP program’s results. However, the OAG believes that the CRA needs to evaluate the effectiveness of its NRAM, improve its monitoring of auditor training and adjust its performance measures to reflect the program’s long-term goal of reducing instances of ATP. The Committee trusts that the CRA will take the necessary steps to implement the improvements identified by the OAG.

41 Ibid., 1535.

42 Ibid., 1600.

43 Ibid., 1535.

APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
Canada Revenue Agency	2014/12/11	43
Lisa Anawati, Director General, International and Large Business Directorate, Compliance Programs Branch		
Ted Gallivan, Deputy Assistant Commissioner, Compliance Programs Branch		
Department of Finance		
Brian Ernewein, General Director, Tax Policy Branch		
Alexandra MacLean, Director, Tax Legislation, Tax Policy Branch		
Office of the Auditor General of Canada		
Michael Ferguson, Auditor General of Canada		
Vicki Plant, Principal		

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* ([Meetings Nos. 43 and 45](#)) is tabled.

Respectfully submitted,

David Christopherson

Chair

