

FILTHY FIVE

CANADA'S TAX LOOPHOLES



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BACKGROUND

The Paradise Papers are the latest leak to reveal the ways in which Canada's tax system continues to benefit the wealthiest Canadians. Offshore tax havens are being used to avoid paying domestic tax on income and to simply store wealth in low tax countries. Loopholes in Canada's domestic tax system contribute to gross inequities, providing wealthy Canadians with tax schemes that allow them to avoid paying their fair share. These tax loopholes directly contribute to growing inequality in Canada; allowing for the rich to get richer, while those with low to middle incomes are left behind. Tax reform is more urgent and necessary than ever.

Ahead of the 2018 federal budget, the Broadbent Institute has put forth recommendations for creating a more just and equitable Canada. These recommendations focus on closing tax loopholes and cracking down on offshore tax havens. This document outlines the 'Filthy Five' tax loopholes in Canada that must be closed. The revenue of these loopholes can be up to \$12 billion, depending on current tax rates, and/or the amount of claims made by the groups exempted from our recommendations.¹ This is money that should be used to pay for better health and social programs for all Canadians.

CALL TO ACTION

The Broadbent Institute calls on the federal government to crackdown on tax loopholes and offshore tax havens used by the country's wealthiest Canadians. These "Filthy Five" tax loopholes contribute to growing inequality in Canada and starve the government of the revenue much needed for health and social programs.

- 1. Partial Inclusion of Capital Gains loophole**
- 2. Employee Stock Option loophole**
- 3. Business Entertainment Expense loophole**
- 4. Dividend Gross-up and Tax Credit loophole**
- 5. Offshore Tax Havens**

¹ Total may be less depending on the current dividend tax rate, and the number of entertainment deduction claims made by small business owners.

Figure 1

Full List Of Lost Tax Revenue

TAX LOOPHOLE	PROJECTED REVENUES FOR 2018 (IN \$MILLIONS)
Partial Inclusion of Capital Gains Loophole ²	\$6,265
Employee Stock Option Loophole ³	\$755
Business Entertainment Expense Loophole ⁴	\$200
Dividend Gross-up and Tax Loophole ⁵	\$4,870
Offshore Tax Havens	\$400
TOTAL⁶	\$12,490 (theoretical maximum)

CAPITAL GAINS LOOPHOLE

The partial inclusion of capital gains amounts to a special tax rate for the rich. When a person purchases a stock or property and sells it for more than what it was originally bought at, the difference between the original price and the price it was sold is only taxed at 50%, rather than recognized as income. Ninety per cent of the tax claims goes to the top 1% in Canada.⁷

RECOMMENDATION: FULL TAXATION OF CAPITAL GAINS. TAXATION ON CAPITAL GAINS SHOULD BE RAISED TO 100%.

² Department of Finance. Report on Federal Tax Expenditures - Concepts, Estimates and Evaluations 2017. Retrieved from <https://www.fin.gc.ca/taxexp-depfisc/2017/taxexp1702-eng.asp>

³ Ibid.

⁴ Ibid.

⁵ The dividend tax credit assumes that the corporation paid the statutory rate of 25% but the effective rate can be as low as 15% on new investments. By proposing to cut, rather than reduce this tax credit, the estimated revenue in Figure 1 may be lower.

⁶ Theoretical Maximum

⁷ Murphy, B., Veall, M. & Wolfson, M. (2015). Top-End Progressivity and Federal Tax Preferences in Canada: Canadian Tax Journal. 63.3, 661-88.

EMPLOYEE STOCK OPTION LOOPHOLE

This is a loophole that taxes income from employee stock options as if they were capital gains (50% deduction) rather than as income. Employee Stock Options are shares that are purchased by employees through their employee stock option plan at a set price. If the stock goes up, the employee can still buy it at the initially set price and sell their stocks at the new rate, while collecting a capital gain. The capital gain is taxed at 50%. Nearly all deductions go to the top 1% of income earners in Canada.⁸ It is a tax break for the rich.

**RECOMMENDATION: TAX CAPITAL GAIN AS IF IT WAS INCOME AT 100%.
THE 50% DEDUCTION SHOULD ONLY CONTINUE FOR EMPLOYEES OF
SMALL START-UP COMPANIES.**

BUSINESS ENTERTAINMENT EXPENSE LOOPHOLE

This tax loophole allows businesses to deduct up to 50% of their meals and entertainment. Business deductions can be claimed for sporting events, restaurants and outings, regardless if business is actually being conducted.

**RECOMMENDATION: ELIMINATE THIS DEDUCTION, AND ONLY ALLOW A
50% DEDUCTION FOR SMALL BUSINESS OWNERS.**

⁸ Ibid.

DIVIDEND GROSS-UP AND TAX CREDIT LOOPHOLE

The dividend tax credit is a special tax break for the rich. It assumes that a company has paid its corporate tax rate; therefore, making the case for individuals to receive a dividend tax credit in order to avoid “double taxation” on dividend shares received. Growing evidence shows that corporate tax rates are in fact quite low, and that some corporations are avoiding paying taxes altogether.⁹ Furthermore, most of this tax credit goes to the top income earners: 91% of this benefit goes to the top 10% and half of it is accumulated by the top 1%.¹⁰ This tax loophole also easily allows for income sprinkling (income transferred to family members in a lower tax bracket) to occur.

RECOMMENDATION: LIMIT THE TAX CREDIT TO THE ACTUAL TAX RATE PAID BY CORPORATIONS BY MAKING THE TAX CREDIT EQUAL TO TAX ACTUALLY PAID BY THE COMPANY ISSUING THE DIVIDEND.

OFFSHORE TAX HAVENS

The Paradise Papers are the latest leaked documents to reveal prominent Canadians and former government officials avoiding taxation by storing their money in offshore tax havens. Here are three immediate measures that will effectively begin the process of cracking down on offshore tax havens.

A. Providing an estimate of the tax gap (Canada Revenue Agency)

We call on all members of the Senate and the government to support Bill S-243: An Act to amend the Canada Revenue Agency Act (reporting on unpaid income tax).¹¹ Canada’s tax gap is currently unknown. A tax gap is the difference between the money that is owed and the money that is currently being collected. Canadians deserve to know how much money is lost each year due to international tax avoidance. This bill calls for the revenue minister to provide the Parliamentary Budget Officer with data in order to calculate an independent estimate of the tax gap.

⁹ Oved, C. M, Heaps, A. A, Toby, & Yow, M. (2017, December 14). Canada’s Corporations Pay Less Than You Think. *The Toronto Star*. Retrieved from <http://projects.thestar.com/canadas-corporations-pay-less-tax-than-you-think>

¹⁰ Macdonald, David. 2016. “Out of the Shadows.” Canadian Centre for Policy Alternatives. https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2016/11/Out_of_the_Shadows.pdf

¹¹ *An Act to amend the Canada Revenue Agency Act (reporting on unpaid income)*. (2017). Retrieved from <https://www.parl.ca/LegisInfo/BillDetails.aspx?Language=E&billId=9264702>

B. Crack down on offshore tax havens without economic substance

We call on the government to support Bill C-362: An Act to Amend the Income Tax Act (economic substance).¹² This bill will crack down on corporate offshore accounts that continue to receive tax breaks despite not being used for economic activity, but simply to store wealth.

C. Conduct full review of tax information exchange agreements (TIEA)

We call on the government to examine the usefulness of Canada's Tax Information Exchange Agreements (TIEA) and close the loophole that allows companies who store money in offshore tax havens to transfer money back to Canada without paying domestic tax. According to statistics Canada, \$55 billion has flowed legally from offshore accounts in countries with a TIEA between 2011 and 2015.¹³

CONCLUSION

The federal government must close these tax loopholes in the 2018 budget and fully support Bill C-362 and Bill S-243 in order to fulfill their campaign promise to put an end to unfair tax breaks for the wealthy.¹⁴ Closing these loopholes will provide the federal government with up to \$12 billion annually,¹⁵ and will lay the foundation for creating a more progressive tax system; one in which everyone is required to pay their fair share.

¹² *An act to amend the Income Tax Act (economic substance)*. (2017). Retrieved from <http://www.parl.ca/DocumentViewer/en/42-1/bill/C-362/first-reading>

¹³ Statistics Canada. *International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country*. Retrieved from <http://www5.statcan.gc.ca/cansim/a26?lang=eng&id=3760051>

¹⁴ Liberal Party of Canada (2017). *Ending Unfair Tax Breaks*. Retrieved from <https://www.liberal.ca/realchange/ending-unfair-tax-breaks>

¹⁵ Total may be less depending on the current dividend tax rate, and the number of entertainment deduction claims made by small business owners.