# FILTHY FIVE

## CANADA'S TAX LOOPHOLES

PART 2

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INSTITUT BROADBENT INSTITUTE

## EXECUTIVE SUMMARY

Tax reform is more urgent and necessary than ever. During the 2019 federal election, the Liberals promised a comprehensive public review of tax breaks, in an effort to make Canada's tax system more fair. Tax loopholes in Canada's 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 the rich to get richer, while those with low to middle incomes are left behind.

In 2015, the Liberals won a majority government, committing to a review of tax expenditures and cancelling tax breaks for the wealthy — specifically the stock option loophole and for private corporations. Since then, the Liberal government has only made modest changes to improve our tax system, leaving some of Canada's worst tax loopholes open. Present day conversations about taxes have now evolved to highlight unfair tax breaks for foriegn-based e-commerce corporations and the lack of taxes paid for extreme wealth held by Canada's richest.

Closing just a few of the most regressive tax loopholes would generate at least $16 billion annually[1] while implementing a 1% tax on wealth over $20 million would raise $70 billion over 10 years, according to estimates by the Parliamentary Budget Officer.[2] These additional billions could help fund programs that would make life much more affordable for Canadians, such as access to housing and healthcare. Fair taxation can help us build a country where everyone prospers.

The political climate is promising in this newly elected Liberal-minority parliament. With support from opposition parties on the issue of tax fairness, the time is ripe for implementing solutions to achieve a more fair and just economy. A recent survey commissioned by the Institute, shows

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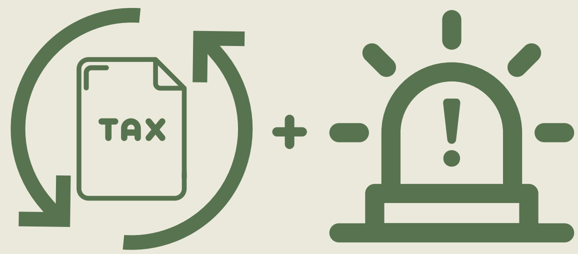
[1] Canadians for Tax Fairness. (2019). *Close Tax Loophole*. Retrieved from https://www.taxfairness.ca/sites/default/files/factsheets/tax_loopholes_fact_sheet_2019.pdf

[2] Office of the Parliamentary Budget Officer. (2019). *Cost Estimate of Election Campaign Proposal*. Retrieved from https://www.pbo-dpb.gc.ca/web/default/files/Documents/ElectionProposalCosting/Results/32630202_EN.pdf?timestamp=1579539525996

that an overwhelming majority of Liberal, NDP and Green voters would like to see cooperation among the parties to increase taxes on the wealthy — and close tax loopholes to ensure everyone pays their fair share.

**Amid growing economic inequality and affordability challenges that plague many Canadians, progressive tax reform has never been more urgent.**




## THE 'FILTHY FIVE' TAX LOOPHOLES: Status Report

In 2018, the Broadbent Institute identified the five worst tax loopholes in Canada's tax system. Little has been done to address these loopholes, which still drain money out of the public purse.

| | 2015 | 2016 | 2017 | 2018 (projected) | 2019[3] (projected) |
|---|---|---|---|---|---|
| **Lower taxes on Capital Gains** | **11,935[4]** | **12,910** | **18,580** | **16,115** | **16,680** |
| **Stock Option Deduction** | **685** | **550** | **630** | **660** | **685** |
| **Business Entertainment Expense** | **490** | **495** | **495** | **500** | **500** |
| **Dividend Gross-up and Tax Credit** | **5,780** | **4,475** | **5,345** | **5,415** | **5,340** |
| Offshore Tax Dodging | 10 billion to 15 billion every year.[5] | | | | |

Sources: Finance Canada, Report on Federal Tax Expenditures - Concepts, Estimates and Evaluations, 2019

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[3] 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
[4] Personal and corporate taxes combined.
[5] The Office of the Parliamentary Budget Officer. (2019). *Preliminary Findings on International Taxation*. Retrieved from https://www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/2019/Preliminary-Findings-International-Taxation/Report%20final.pdf

## STOCK OPTION DEDUCTIBLE

Profits from stock options for CEOs and others are taxed at half the rate of other employment income.

STATUS: SOME PROGRESS, WITH PROPOSAL TO PARTIALLY CLOSE

In the 2019 federal budget, the Liberal government proposed changes to the employee stock option deductible, capping the annual amount that can be claimed for large, mature companies. This proposal would cap the stock option deduction at $200,000 annually for employees of "large mature" firms, but otherwise leave it open. The loophole should be closed entirely.

## CAPITAL GAINS

Only 50% of profits from selling stock or property are taxed. The other half is tax free income. Ninety per cent of the claims under this loophole go to the richest 10% in Canada.

STATUS: NO PROGRESS

Recommendation: All profits from capital gains, with the exception of principal residences,[6] should be taxed as income, which would bring in $16.5 billion.

[6] Capital gains from the sale of a principal residence are tax exempt under our current tax system. https://www.fin.gc.ca/taxexp-depfisc/2019/taxexp1906-eng.asp#Non-taxation-of-capital-gains-on-principal-residences

## CORPORATE MEALS AND ENTERTAINMENT EXPENSES

Half of expenses claimed as “meals and entertainment,” including costs for corporate perks such as sports sky boxes and elite club memberships, can be deducted from taxable income by businesses.

**STATUS: NO PROGRESS**

Recommendation: Eliminate this loophole and allocate 25% of the revenues towards a tax credit for legitimate small business use. This deduction would bring in $500 million annually.

## CORPORATE DIVIDEND TAX CREDIT

Personal income tax credits are given for stock dividends based on the assumption that the issuing corporation paid the statutory corporate tax rate. However, many corporations pay far less than the statutory rate because it can take advantage of different tax avoidance schemes.

**STATUS: NO PROGRESS**

Recommendation: The corporate dividend tax credit should be strictly limited by making the tax credit equal to the taxes actually paid by the company issuing the dividend, which would bring in $1 billion.

## OFFSHORE TAX HAVENS INTERNATIONAL TAX DODGING

Large corporations can transfer profits to low or zero tax jurisdictions to avoid paying their fair share. Tax haven abuse costs all countries, especially developing nations. While there are ongoing discussions through the OECD to fix the international corporate tax system and stop profit-shifting, countries including Canada can take action on their own.

In our initial Filthy Five report, the Institute recommended three measures for the government to tackle the problem. They included:

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

STATUS: SOME PROGRESS

To effectively combat tax haven use, the federal government needs a clearer picture of how much is lost to tax dodging. While the Canada Revenue Agency has started reporting on the tax gap, it is not bound to by law. In May 2019, the Liberals voted down[7] Senator Percy Downe's Bill S-243: An Act to amend the Canada Revenue Agency Act (reporting on unpaid income tax) that would have required the CRA to report on Canada's tax gap and allow the PBO to provide an independent analysis on the findings.

**Crack down on offshore tax havens without economic substance**

STATUS: NO PROGRESS

[7] Canadians for Tax Fairness. (2019). *Government Rejects Senator's Tax Fairness Bill.* Retrieved from https://www.taxfairness.ca/en/news/government-rejects-senator%E2%80%99s-tax-fairness-bill

In 2017, Member of Parliament Murray Rankin, introduced a private member's bill to crack down on offshore tax havens. Bill C-362: An Act to Amend the Income Tax Act (economic substance) would deny tax breaks to money stored in offshore accounts without real economic purpose. The bill did not reach a vote before the last parliament ended and subsequently died on the Order Paper.

**Conduct full review of tax information exchange agreements (TIEA)**

STATUS: NO PROGRESS

Canada's Tax Information Exchange Agreements (TIEA) allow 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.

Recommendations: The federal government adopt the five measures outlined by Canadians For Tax Fairness[8] in their 2019 Platform for Tax Fairness document:

1. Canada should take a lead in advocating for and implementing fundamental reform of the international corporate tax system
2. Stronger enforcement and penalties to confront tax evasion and aggressive tax avoidance by high incomes and corporations
3. Increased funding to the Canada Revenue Agency (CRA) for investigation, audits, enforcement and prosecution of offshore, corporate and high income tax evasion
4. Restrict corporations or consortiums that engage in tax evasion and aggressive international tax avoidance from obtaining federal government contracts
5. End double non-taxation agreements with tax havens

Canadians for Tax Fairness estimated these measures could generate at least $6 billion in revenue.

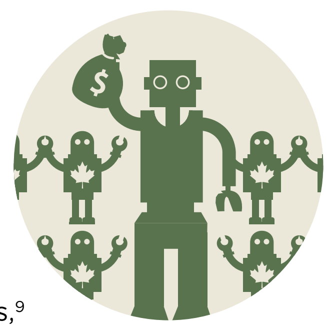
[8] Canadians for Tax Fairness (2019). *Platform for Tax Fairness.* Retrieved from https://www.taxfairness.ca/sites/default/files/resource/c4tf_draft_federal_election_2019_platform_proposals_.pdf

## FAIR TAXATION OF DIGITAL GIANTS AND EXTREME WEALTH

Since the release of our first instalment of the Broadbent Institute's Tax Fairness Report, the conversation on tax avoidance and evasion has evolved. In addition to the current egregious 'Filthy Five' tax loopholes, corporations and e-commerce companies like Netflix, Youtube, Google and other foreign digital companies can avoid paying corporate income tax in Canada and do not have to collect or remit sales tax.

Moreover, wealth that has been accumulated by the top 1% continues to go undertaxed as Canada remains one of the few G7 countries without an inheritance tax and/or an alternative form of taxing generational wealth.

## DIGITAL TAXES



E-commerce corporations like Netflix and Google, pay little to no taxes in Canada, despite occupying a near monopolistic share of the online and media market. Current federal tax law on e-commerce applies only to domestic companies,[9] granting digital giants outside Canada an unfair tax break. According to Canadians for Tax Fairness, foreign e-commerce companies totalled over $20 billion in Canadian revenue in 2017.[10] That amount is likely considerably higher today. This creates an unfair landscape where Canadian companies and media are unable to compete with large foreign multinationals hurting our economy — in favour of delivering tax breaks to multi-billion dollar corporations.

Recommendation: Apply GST and HST to imports of digital services and apply corporate tax to the business digital companies conduct in Canada.

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[9] Government of Canada. *GST/HST and e-commerce*. Retrieved from https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/gst-hst-businesses/charge-collect-specific-situations/e-commerce.html#whch

[10] Canadians for Tax Fairness. *Tax foreign-based E-commerce Companies to Level the Playing Field*. Retrieved from https://www.taxfairness.ca/sites/default/files/resource/c4tf_draft_federal_election_2019_platform_proposals_.pdf

## WEALTH TAX

A 2018 report by the Canadian Centre for Policy Alternatives found that 87 of the richest families in Canada own approximately the wealth of 12 million Canadians, with a total net worth of $259 billion. Canada has neither a wealth, nor an inheritance tax. As a result, wealth is passed down through generations, and accumulated over time — untaxed in the form of assets and capital. This further exacerbates inequality, allowing the rich to get richer, widening the economic gap between everyday Canadians. Additionally, a wealth tax would raise government revenues, allowing for increased spending for the health and social programs Canadians rely on the most.

Recommendation: Implement a federal wealth tax that is accompanied by an aggressive plan to tackle offshore tax avoidance and evasion, along with the closure of tax loopholes that benefit the wealthy. Together, these measures will limit the amount of wealth that can be hidden in offshore accounts and help to ensure such a tax is enforced and effective in generating revenue.

## CONCLUSION

Ensuring that the rich pay their fair share through a variety of policy measures, and holding corporations to account is the best path forward to restoring integrity to our tax system.

The federal government should move to close these tax loopholes in the tabling of its 2020-21 budget. Eliminating these loopholes will provide Canada with additional revenue to invest in important public services and will lay the foundation for creating a more progressive tax system; one in which everyone is required to pay their fair share.