Funding the Future

Beating the Canadian tax gap

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I have evidence in the Canadian parliament (by video link) this afternoon:

This is what I had to say on the proposed Canadian tax gap measure:

Thank you for asking me to give evidence today.

I have reviewed the proposed legislation that you are discussing that will amend section 88 of the Canada Revenue Agency Act.

I have noted the definition of the tax gap that the draft legislation proposes. That definition is welcome, but is also problematic:

* *Firstly, it would appear to be limited to* tax *assessed under your Income Tax Act but there are, of course, other taxes and a narrow focus may be inappropriate.*

* *Second, I think it fair to say that whilst the definition used does seek to identify a tax evaded on undeclared income plus the amount of bad debt suffered on income assessed, but not collected, by the Canada Revenue Agency it does not appear to address issues of tax avoidance, and is ambiguous on the issue of profit shifting out of Canada, and so may be incomplete.*

* *In addition, and thirdly, I would suggest that any tax gap gap estimate that now fails to consider the amount of tax not collected as a result of official policy, reflecting the cost of all allowances, reliefs, reduced rates, and other exemptions that might have been granted by governments over time, fails to take into consideration the potential cost that these reliefs impose on taxpayers, which may need to be subject to continuous reappraisal if the tax gap is to clearly reflect the potential tax recovery available to any government at a point in time.*

* *For these reasons I would suggest that you need to expand your definition of the tax gap to include other taxes, tax avoidance and full assessment of the tax cost of revenues apparently willingly forgone so that this is understood by all who make*

decisions on tax policy issues. My concern is that you have information that can inform your decision making: at present *I am not sure you will get that.*

I have also noted the basis on which it is suggested that tax gap data will be estimated. This is technically described as a 'bottom-up' approach.

* *In a bottom-up approach to tax gap* estimation *the errors that a tax authority identifies in returns submitted to it are aggregated and extrapolated in an attempt to determine the likely error rate in the taxpaying population as a whole. I stress, this is a useful exercise: it helps you appraise the likely yield that you could raise if you were to allocate more resources to your tax authority to undertake more audits of taxpayer activity. So I would not suggest that you abandon this exercise.*

* *However, I do not think that a bottom-up approach is a sufficient basis for estimating tax gaps. The problem with using tax returns as the basis for the tax gap is that this approach is not enough to get a proper estimate precisely because so many tax evaders do not submit returns at all, whilst legal but unacceptable tax avoidance is also not identified in bottom-up approaches. This problem cannot be overcome by some sampling and what is, politely, guesswork.* Instead *the model used by the European Commission to measure the VAT tax gap across the EU is what is required. This is a* top down *measure that bases the estimated tax lost on GDP data, including that on the size of the shadow economy, to produce a more reliable estimate of total tax foregone. Reconciling the two approaches then provides an estimate of what is really lost to the shadow economy and abusive behaviour. As a* result *an estimate of what might be, at least theoretically, recoverable by enhancing resources addressed to identifying that shadow economy is then available. Without* this *I think that any measure of the tax gap is, necessarily incomplete.*

Summary

* *In summary, I welcome the proposal you are discussing and hope you will adopt it, but also hope that you will go much further because beating Canadian tax abuse requires that you do so.*