



CANADA

# **JOBS GROWTH AND LONG-TERM PROSPERITY**

**ECONOMIC ACTION PLAN 2013**

**IMPROVING THE INTEGRITY OF THE TAX SYSTEM**

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# Economic Action Plan 2013

## Improving the Integrity of the Tax System

In an uncertain global environment, the most important contribution the Government can make to help create jobs, growth and long-term prosperity is to maintain a sound fiscal position. Managing tax dollars wisely ensures sustainable public services and low taxes for Canadian families and businesses.

The Government is committed to responsible fiscal management, which includes returning to balanced budgets by 2015–16 and controlling spending. It also includes continuing to enhance the integrity of the tax system to ensure that everyone pays their fair share of taxes. Such actions help keep taxes low for Canadian families and businesses, thereby improving incentives to work, save and invest in Canada.

In previous budgets, the Government adopted tough rules to close tax loopholes and prevent a select few businesses and individuals from avoiding taxes.

Since 2006, and including measures proposed in Economic Action Plan 2013, the Government has introduced over 75 measures to improve the integrity of the tax system.

Economic Action Plan 2013 takes steps in the following areas:

- Improving integrity and closing tax loopholes.
- Strengthening compliance.
- Combating international tax evasion and aggressive tax avoidance.
- Consulting Canadians.



## Improving Integrity and Closing Tax Loopholes

- Enhancing corporate anti-loss trading rules to address planning that avoids these rules.
- Ensuring that the loss pools of trusts cannot be inappropriately traded among arm's-length persons.
- Further extending the application of Canada's thin capitalization rules— i.e., rules that limit the amount of Canadian profits that can be distributed to certain non-resident shareholders as deductible interest payments— to Canadian resident trusts and non-resident entities.
- Ensuring that the tax consequences of disposing of a property, such as capital gains tax, cannot be avoided by a taxpayer by entering into transactions (“synthetic dispositions”) that are economically equivalent to a disposition of the property, but where legal ownership of the property is retained by the taxpayer.
- Ensuring that derivative transactions cannot be used to convert fully taxable ordinary income into capital gains taxed at a lower rate.
- Eliminating unintended tax benefits relating to leveraged insured annuities and leveraged life insurance arrangements.
- Clarifying that reports, examinations and other services performed for a non-health-care-related purpose do not qualify for the Goods and Services Tax/Harmonized Sales Tax (GST/HST) exemption for basic health care services.
- Clarifying that commercial paid parking is subject to GST/HST when supplied by a municipality, university, public college, school, hospital, or any entity established by one of these bodies.
- Clarifying legislation to respond to court decisions and restore the intended tax policy results in the areas of farm losses, non-resident trusts and future reclamation costs.



## Examples of Tax Planning Addressed in Economic Action Plan 2013

### ***Loss-Trading***

If Company A and Company B each earn \$10 million, they should each pay the same amount of income tax. Since revenues can go up and down over time, however, the tax rules allow losses from previous years to be used to offset income from other years. While the tax rules permit Company A to use its own losses against income from other years, there are rules that prevent Company A from buying an inactive company—Company C—and using Company C's loss pools to avoid paying tax on its \$10 million of income. Economic Action Plan 2013 strengthens these rules in two ways. First, it closes a loophole that may allow Company A to, instead of buying control of Company C, sell income-producing assets to Company C (for non-voting shares in Company C) so that the income and losses can now be offset in the same company. Second, it introduces anti-loss trading rules for trusts, which will be similar to the rules that apply to corporations, so that taxpayers cannot avoid the loss-trading restrictions by using a different business structure.

### ***Synthetic Disposition***

Acme Corporation owns \$10 million worth of shares of ABC Co. that it bought several years ago for \$1 million. Acme wants to sell the shares but would like to avoid paying tax if possible. If Acme sold the shares today, it would be taxed on a \$9 million capital gain. In order to effectively sell the shares while deferring tax on this capital gain, Acme enters into a "synthetic disposition" transaction. Here is how it works:

- Acme gets a ten-year loan for \$10 million from a bank.
- Under the loan terms, Acme can pay off the loan in ten years by transferring the ABC Co. shares to the bank. In return, the bank gets the right to acquire the shares from Acme in ten years for the same \$10 million. As a result, Acme has no risk of loss but also no opportunity for gain on the shares.
- At the end of the ten years, if the value of the shares is less than \$10 million, Acme could pay off the loan by transferring ownership of the shares to the bank. If the value of the shares is more than \$10 million, the bank could still get the shares for \$10 million.
- Acme Corporation therefore has its \$10 million and no longer gains any benefit from an increase in value of the shares or suffers any loss from a decrease in value of the shares. In other words, it has effectively sold them—and it has done so without paying tax on the capital gain.

Economic Action Plan 2013 includes a tax rule to treat Acme as having sold the ABC Co. shares at their fair market value of \$10 million when it enters into the arrangement and will treat Acme Corporation as having repurchased the shares at a cost of \$10 million. This means that Acme will have an immediate capital gain of \$9 million upon entering into the transaction. This capital gain will be subject to tax—just as if Acme had sold the shares outright. After all, this is what Acme would have done in the first place if it were not for the tax planning scheme described above.



## Strengthening Compliance

- Introducing new administrative monetary penalties and criminal offences to deter the use, possession, sale and development of electronic suppression of sales software that is designed to falsify records for the purpose of tax evasion.
- Revising Scientific Research and Experimental Development (SR&ED) claim forms to require more detailed information to help identify claims with a higher risk of non-compliance, as well as imposing a new penalty of \$1,000 for each SR&ED claim where required information is missing, incomplete or inaccurate.
- Extending the reassessment period for reportable tax avoidance transactions and tax shelters when information returns are not filed properly and on time.
- Permitting the Canada Revenue Agency (CRA) to collect up to 50 per cent of amounts in dispute in respect of tax shelter claims that involve a charitable donation.
- Providing the Minister of National Revenue the authority to withhold the payment of GST/HST refunds claimed by a business, where the business has failed to provide the CRA with all of the information required as part of the GST/HST registration process.

## Combating International Tax Evasion and Aggressive Tax Avoidance

- Announcing a new Stop International Tax Evasion Program, which will enable the CRA to pay individuals with knowledge of major international tax non-compliance a percentage of tax collected as a result of information provided.
- Requiring certain financial intermediaries, including banks, to report their clients' international electronic funds transfers of \$10,000 or more to the CRA.
- Streamlining the CRA process for obtaining information concerning unnamed persons from third parties such as banks.



- Revising the Foreign Income Verification Statement (Form T1135) to require reporting of more detailed information.
- Extending the reassessment period for taxpayers who have failed to report income from a specified foreign property on their annual income tax return and failed to properly file the Foreign Income Verification Statement (Form T1135).

## Consulting Canadians

- Consulting members of the tax community and other Canadians on access to graduated personal tax rates for certain trusts.
- Consulting members of the tax community and other Canadians on the issue of “treaty shopping,” where payments are made from Canada to an entity that resides in a Canadian treaty partner to benefit from preferential Canadian treaty provisions.

By closing tax loopholes, addressing aggressive tax planning, clarifying tax rules and reducing international tax evasion and aggressive tax avoidance, the Government will continue to ensure a system that is fair for everyone. In doing so, it will build on the responsible management that has kept taxes low and Canadian net debt the lowest by far among Group of Seven (G-7) countries.

To learn more about what Economic Action Plan 2013 will mean for you, visit [actionplan.gc.ca](http://actionplan.gc.ca).



## Improving the Integrity of Canada's Tax System: A Track Record of Success

Since 2006, the Government has introduced over 75 measures to improve the integrity of the tax system. Examples of measures introduced by this Government prior to Economic Action Plan 2013 include:

- Strengthening the charitable donations system by enhancing the regulatory regime for registered charities.
- Introducing an information reporting regime for tax avoidance transactions and improving tax shelter reporting rules.
- Addressing the use of partnerships in corporate tax avoidance or deferral.
- Addressing self-dealing arrangements involving Retirement Compensation Arrangements, Registered Retirement Savings Plans and Tax-Free Savings Accounts.
- Addressing "foreign tax credit generator" transactions that were designed to shelter tax otherwise payable on interest income on loans made, indirectly, to foreign corporations.
- Introducing a tax on the income of specified investment flow-through entities (SIFTs, commonly known as "income trusts"); subsequently, ensuring that corporate anti-loss trading rules apply on SIFT conversions to corporate form, and also ensuring that stapled securities cannot be used to frustrate the SIFT regime.