Filling in the tax gap: What to expect from CRA audits and investigations

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Key takeaways

- The new federal tax gap report identifies key areas of tax non-compliance or non-payment.
- Public opinion is pushing the Canada Revenue Agency (CRA) to identify and address issues with offshore personal income tax non-compliance and avoidance in priority.
- Corporations operating in certain sectors identified as high-risk in terms of non-compliance will likely be subject to increased audit scrutiny.
- The CRA is increasing its focus on tax non-compliance in the cryptocurrency and cannabis sectors.

In its June 2022 "Overall Federal Tax Gap Report, 2014-2018" (the Tax Gap Report, or the Report), the CRA estimates that its net tax gap for 2018 ranges between $18.1 billion and $23.4 billion.

The Tax Gap Report defines the tax gap as the difference between the taxes that would be paid if all tax obligations were met and the taxes that were actually collected by the CRA. Importantly for taxpayers, the Report identifies certain corporations, sectors, and high-net-worth individuals as high-risk and subject to future monitoring, intelligence gathering, and potential audits, thus providing insight as to the CRA's focus in future audits and investigations.

Closing the personal income tax gap

The personal income tax (PIT) gap is comprised of two principal forms of non-compliance:

- individuals not reporting income earned through Canada's so-called underground economy; and
- potential tax revenue loss from hidden offshore investment income.

Approximately 70 per cent of the PIT reporting gap was the result of Canada's underground economy, that is, employees or self-employed individuals with undeclared forms of income, such as cash payments, payments in kind and other unrecorded income.

Although the recent media focus often falls on offshore tax dollars, the Report identifies offshore tax planning as comprising a relatively small share (30 per cent) of the PIT reporting gap. However, the Report also notes that Canadians believe it is more important to address offshore non-compliance compared to domestic non-compliance. Accordingly, the CRA is seeking to identify those who underreport foreign income by using tools such as data derived from offshore leaks and internationally focused audits of high-risk individuals.

The Report also suggests that the CRA will seek to acquire a better understanding of tax non-compliance related to capital gains in the international market to address the international component of the PIT gap.

As part of its efforts to reduce international tax non-compliance, the government of Canada will invest $606 million over five years to hire additional offshore-focused auditors to identify individuals who avoid taxes by relocating income and assets offshore. The CRA is also using a number of offshore information-sharing activities, such as automatic investigations for electronic fund transfers over $10,000, to supplement its mission to reduce the personal income tax gap, as well as a reward program for informer tips.

In addition to non-reporting, the Report identifies non-payment as another contributing factor to the PIT gap. The Report states that non-compliant individuals at the payment deadline were more likely to be married or common-law males aged 45 to 64 with reported income between $25,000 and $93,000 from Alberta or Québec, while individuals with long-standing tax debt were more likely to be unmarried males aged 35 to 54 from Ontario. People in these categories are likely to be the target of future audits.

Closing the corporate income tax gap

The Report estimates that incorporated small and medium-sized enterprises (SMEs) contributed to approximately 30 per cent of the corporate income tax (CIT) reporting gap, with large corporations contributing approximately 70 per cent. With respect to non-payment of corporate income tax, the Report identifies certain corporations from Alberta, Québec, and Nova Scotia as high-risk for non-compliance.

Specifically, the Report states that non-compliant SMEs at the payment due date were more likely to be relatively new Canadian-controlled private corporations (CCPCs) from Alberta in the professional, scientific and technical services, as well as transportation and warehousing sectors. SMEs with long-standing tax debt were more likely to be CCPCs from Alberta and Québec in the construction sector.

Non-compliant large corporations with respect to tax payment tended to be CCPCs from Alberta in the construction and retail trade sectors. Large corporations with long-standing tax debt tended to be public corporations from Nova Scotia and Québec in the finance and insurance as well as professional, scientific and technical services sectors.

If enforcement trends are data-driven, we can expect to see increased audit scrutiny in these sectors and geographies.

Increasing the focus on cryptocurrency and cannabis

The Tax Gap Report also suggests that the CRA is seeking to boost its intelligence and understanding in emerging sectors, such as cryptocurrency and cannabis.

Specifically, the Report notes that the CRA will be looking more closely at cryptocurrency transactions to enforce personal income tax and GST/HST compliance. To aid its efforts, the CRA has established a special unit to address non-compliance in the cryptocurrency sector. We have already seen increased audit activity of the cryptocurrency sector and expect such activity to continue.

The CRA currently conducts regulatory reviews of licensed and registered manufacturers of tobacco or cannabis products to ensure that excise stamps are correctly applied. The Report notes that future tax gap reports will incorporate non-compliance in areas such as the cannabis excise duty and federal fuel charge.

The minister of National Revenue and the commissioner of the CRA have identified this Tax Gap Report as revealing key findings for the government's commitment to combat non-compliance with tax obligations. This Report, along with increased funding and tools for the CRA, surely signals an increase in investigations and audits for the individuals and companies identified above.

If you have further questions about the Tax Gap Report, reach out to your BLG lawyer, the authors of this article, or any member of BLG's Tax Group.

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