



ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

INVESTMENT INDUSTRY ASSOCIATION OF CANADA

**THE TAXING TRUTH –
CANADA NEEDS TO RATIONALIZE
TAX REPORTING FOR INTERMEDIARIES**

A DISCUSSION PAPER

Submission to the Canada Revenue Agency, November 21, 2007 (R)

The Investment Industry Association of Canada (IIAC) is a member-based, professional association that advances the growth and development of the Canadian investment industry. IIAC acts as a strong, proactive voice to represent the interests of the investment industry for all market participants. Our member firms range in size from small regional firms to large organizations that employ thousands of individuals across the country. Our members work with Canadians to help build prosperity and investment security for investors and their families.

The IIAC's aims are fourfold:

Advocacy: To be the voice of the investment dealer and brokerage industry, advocating on regulatory and public policy issues for an investment environment that is efficient for our members and that fosters savings and investment by Canadians

Industry profile: To build a better appreciation of the contribution that the securities industry makes to Canadians, to Canada's capital markets and to the Canadian economy

Member support: To offer operational support that contributes to the ongoing success of our members and to their ability to cost-effectively serve investors and issuers

Market advancement: To promote globally competitive capital markets for Canada.

PURPOSE

To reach agreement between the Canada Revenue Agency (CRA) and the Investment Industry Association of Canada (IIAC) on:

- A plan of action to achieve measurable efficiencies and streamlining in investment tax and other tax reporting processes to reduce direct and indirect costs and frustration for small and large intermediaries, issuers and the CRA and, by extension, investors and taxpayers
- A process to communicate with the Department of Finance, Ministère des finances du Québec and Revenu Québec following budgets or other events that require a tax reporting change.

“Tax and benefits systems that function well are fundamental to the economic, fiscal, and social health of a nation. Ensuring that these systems are administered as efficiently and effectively as possible is an objective that is shared by all levels of government.”

– *Agency 2010*, Canada Revenue Agency (CRA)

SUMMARY

While federal tax rates have been dropping – a good outcome – the complexity and costs of tax compliance have been increasing substantially – a bad outcome. **Investment dealers alone pay \$20 million in additional costs (“tax”) annually by being among the CRA’s un-reimbursed tax reporting facilitators.** Moreover, these firms risk incurring penalties and interest if requirements are not adhered to properly and, in capital markets, where certainty is critical, these firms have not been provided with sufficient government administrative assistance (see **Appendix 1 – Eligible Dividend Case Study**).

Despite the work of individual CRA staff, meaningful communication between the CRA and tax-reporting intermediaries, such as investment dealers, has been limited until recently and efforts to improve administrative processes have been ineffective. It seems that changes to tax reporting are announced with relatively little regard to the intermediaries’ ability to implement them in terms of technology, budget or timing requirements. Often the lead times provided for intermediaries are significantly shorter than those for the CRA. IIAC members require as much advance notice of reporting/tax form changes as possible to ensure as seamless transitions as possible. Ideally, changes to tax forms need to be communicated to intermediaries before the end of August each year instead of too late to manage them efficiently or without jeopardizing their ability to provide tax forms to clients (see **Appendix 2 – T5013 Form Case Study**).

The IIAC and its members play a critical role in conveying information to issuers, and in building and enhancing solutions to facilitate more accurate and timely tax reporting for clients. The government should ensure changes that must be made by intermediaries are truly necessary and can be made cost-effectively.

PRINCIPLES

The CRA’s commitments to taxpayers and small businesses confirm the Canadian government’s stated view that, when implementing legislation and regulations imposing costs on businesses that are otherwise unnecessary to the firms’ operations, the provisions should be as reasonable to comply with as possible (see **Appendix 3**). While we understand that other political priorities may intervene from time to time, we believe that the following five principles will help provide intermediaries – and ultimately the CRA – with a more manageable process.

1. **Electronic communication:** Communication of tax information should increasingly be moved to an electronic and automated format to facilitate issuer, intermediary and CRA

straight-through processing. This would save money, reduce re-keying errors and avoid the need for investors to refile.

2. **Effective consultation:** Finance Canada and the CRA should consult on an ongoing basis with those firms and industries that bear the costs of implementing changes mandated by revisions to tax legislation or CRA requirements.
3. **Practical approaches:** Finance Canada and the CRA should give serious consideration to reporting recommendations from intermediaries and provide practical reason(s) *not* to adopt the recommendations if they achieve the same aims.
4. **Sufficient implementation time:** Information on changes to tax reporting changes must be finalized and conveyed to the firms or industry no later than August 31 each year to allow for reasonable implementation by reporting firms of systems, procedural and communications changes; if this schedule cannot be met, CRA should be able to provide administrative relief provided it is evident that intermediaries have made reasonable efforts to comply.
5. **Service level targets and reporting:** The CRA should set and report against service level standards to intermediaries (as done now to taxpayers in terms of responsiveness measures) including a timeline for providing intermediaries with tax guides, computer specs and tax forms.

PROBLEMS

The problems intermediaries face, reflected in the two appended case studies, are:

1. **Impractical changes/continued use of highly manual processes:** The CRA does not mitigate costs imposed on intermediaries and does not provide explanations for *not* accepting recommendations from investment dealers and other intermediaries. Another recent example – both a Finance Canada and CRA issue – is a new GST form where elements of the new design and guide are contradictory and others require information that may be derived in better ways.
2. **Late notice of new requirements:** While recognizing the problems caused by late receipt by the CRA of Finance tax-related legislation, the CRA defines form and process changes too late for implementation by tax reporting investment dealers and other intermediaries in a reasonable and cost-effective way (refer **Appendix 2**). Intermediaries require at least four months from receiving detailed specs to effectively implement changes.
3. **Lack of communication and consultation to ensure an efficient result:** The CRA appears to undervalue the role of intermediaries in the tax system, and provides little effective communication with them:
 - Firms making their income from the tax system (software providers, accounting firms and printing firms) appear to be informed better by the CRA than the intermediaries that incur costs to comply with, and earn nothing from, tax reporting and that must handle tax-slip-related complaints from their investor clients.
 - CRA publications “Agency 2010” and “Making a Difference for Canadians 2006” make no reference to tax reporting intermediaries. Our suggestions to the former Minister to establish an advisory group and designate a senior CRA contact to ensure continued dialogue with the industry elicited no response.

This is all the more problematic as the significant majority of IIAC members are small businesses and need the CRA to fulfill its promise to minimize costs of compliance, for example, responding on a timely basis to questions appears.

RECOMMENDATIONS

1. Identify and implement improvements benefiting the CRA, Finance, issuers, intermediaries and/or investors

- Involve tax reporters in tax report design and process development to improve tax reporters' and the CRA's business productivity, identifying more automated solutions for the CRA, issuers and tax-reporting financial institutions, relying as much as possible on centralized solutions – the Canadian Depository for Securities (CDS) website that collects T3 and T5013 data is a clear example of an efficiency for all parties that should be extended to other areas; further work is under way for eligible dividend reporting.
- As the obligation to exchange paper not only adds cost and risk of error, but also extends the cycle time of a transfer, work jointly (as some of these rules may not be CRA rules and/or may involve other departments or jurisdictions) to eliminate any requirement to transfer information via paper documents between intermediaries and with the CRA or HRSDC for those intermediaries with electronic capabilities – specific consideration should be given to:
 - Notional information for registered education savings plans (RESPs)
 - Minimum payment obligations for the transfer of registered retirement income funds (RRIFs)
 - Locked-in agreements.
- Approve substitute forms and wording on a timely basis to facilitate greater use of electronic filing; provide answers to questions expeditiously to allow the tax filing firms to develop form logic to reduce errors (as an example, ensure that any issuer entering a tax shelter ID number in the field at the top of the CDS form only completes the relevant segments); to support other filers, once a filing has been accepted, the CDS system could automatically send confirmation not only to the issuer, but also to the CRA, enabling issuers to complete their required filing notification to the CRA automatically.
- Provide taxpayer identification numbers on a same-day basis, especially for trusts, to ensure easy tracking of original tax reporting and easier reconciliation with amendments.
- Have issuers who file amendments late deal directly with the CRA – the work and costs of post-tax-filing-date corrections should not be borne by intermediaries and we believe that tax filers would take filing more seriously if they were to have to deal with the CRA directly following a cut-off date two or three weeks prior to the end of April.
- Establish an industry-CRA committee to address the problems faced by both intermediaries and the CRA by the filing of amendments, especially for NR4s and T3s.
- Streamline non-resident tax (NRT) withholding:
 - Clients are required to ask for refunds using a NR7R form, however, a NR7R must be used for each distribution instead of one form per intermediary per tax year
 - For trust unit and split corporation distributions, intermediaries must provide the CRA with the NRT on the full distribution even though part of the distribution may contain non-taxable components like return of capital
 - Yearly NRT accounts with the CRA close as of December 31, but intermediaries are not in a position to know how much money really should have been withheld until the last trust issuer has reported around March 31 and, then, the clients have to be refunded the money that was overwithheld from their account at the time of distribution, leading to significant out-of-balance situations that the CRA should resolve.
- Reconsider the GST form changes – we are meeting with Finance to raise the GST legislation and form changes, but would appreciate a CRA contact for this issue.

2. Give notice of changes on a timely basis

- Provide draft form changes to intermediaries by early July for their comments by the end of July; accept the recommendation (or explain why acting on any recommendation is not

possible) and provide final details of changes to intermediaries by no later than August 31.

- **Note:** We are also asking Finance to enable the CRA to provide administrative accommodation when legislation is introduced late or demands significant programming for which there is insufficient time to implement required systems and operational changes cost-effectively.

3. **Improve communications to and from the CRA**

- Set up bi-annual meetings – one a month following the budget between CRA, Finance and intermediaries and the second in the fall for discussion of longer-term CRA plans.
- After the Quebec budget is released, meet jointly with intermediaries and Quebec counterparts to discuss Quebec equivalents on a number of matters – we will be approaching Quebec as well, as their choice of an alternative effective date for the dividend eligibility change added considerably to complexity and workload.
- Provide intermediaries with a high-level organizational chart with contact points within the CRA for relevant technical matters (taxpayer identification numbers (TINs), forms, etc.) and assign to the IIAC a “relationship manager,” a role that we believe would be mutually beneficial, to serve as a point person in obtaining timely answers and to disseminate to the IIAC and its members communications that the CRA would like circulated.
- Provide dedicated phone numbers or group e-mail address(es) to obtain responses to technical questions, especially during tax season (as an example, last year it proved to be impossible to reach the CRA through regular tax phone lines to understand why the CRA had issued some income trust TINs that were consistent in style with those issued to corporations rather than to the typical trust TINs); when intermediaries do get through, they will often get different answers from different customer service representatives).
- Establish a tax reporter advisory committee with dealer representation; copy the IIAC and other appropriate individuals on communications with other relevant tax advisors, print firms and service and technology providers so that there is greater consistency and more efficient implementation of changes.
- Host a meeting of parties involved in the tax reporting process – possible co-ordinated through the advisory committee – to better understand each other’s timetables, concerns, ideas for process improvement, etc.
- Establish centralized e-mail communication of changes to interested parties that subscribe to such a service.
- Establish and keep up to date a web page for tax reporters.
- Develop and maintain a database of issuers to facilitate communication between issuers and intermediaries and to co-ordinate communications better.
- Develop and report on service level/response standards as done for taxpayers; identify key data/measures to better be able to assess requests and opportunities for improvement.

4. **Establish service level targets and reporting**

The CRA should set and report against service level standards to intermediaries as done now for information regarding responsiveness to taxpayers.

5. **Provide support in dealing with the U.S. Internal Revenue Service**

The qualified intermediary (QI) requirements under the American Internal Revenue Code are onerous and becoming more so. Some years ago, brokerage firms were keeping senior CRA officials apprised of developments and concerns with the emerging requirements, however, we understand that this practice ceased after these officials indicated that they believed the U.S. requirements were “reasonable.”

As the QI requirements are becoming more burdensome, and as the current government is seeking free trade in securities on a level playing field with other countries, we would like a CRA designate who we can keep apprised of concerns given what we understand to be the open relationship between the Canadian and U.S. tax authorities. Recent examples of problems where CRA support may have been helpful relate to what were seen as minor form changes to Form W-8BEN, which would have resulted in the provision of Canadian social insurance numbers (SINs) to third parties and what would amount to an obligation to terminate relationships with clients that used powers of attorney in circumstances where neither the intermediary nor the client had done anything wrong.

CASE STUDY: ELIGIBLE DIVIDENDS

REPLACE

May 2006 budget provisions announced the federal government's intention to eliminate the double taxation of large corporation dividends through the designation of eligible and ineligible dividends, retroactive to January 2006. Retroactive provisions are always problematic in volume-intensive industries as no systems in place will have caught the information automatically, meaning a very manual process.

- The IIAC provided comments on technical challenges in August and September of 2006. The draft legislation (Bill C-28) did not pass until December and then did not get through the Senate review process until late February of 2007, almost two months into the tax reporting season. While proclamation occurred quickly, the requirement for issuers to file was not effective immediately even then – issuers had until the final week in May 2007, three weeks *after* personal taxes had to be filed and nearly three months after intermediaries had to mail T5s, to make information available to intermediaries.
- Other challenges in administering the eligible dividend legislation included the requirement for *all* issuers to file whether their dividends were eligible or not, although our estimates were that 90-95 per cent of dividends would be eligible – and this proved to be the case. Moreover, intermediaries were to report all dividends as “other than eligible” in circumstances where an issuer had failed to provide notice of dividend eligibility status, which was in virtually all cases. Reporting the majority of dividends as other than eligible would have meant millions of taxpayers would either not enjoy the tax benefits that they were promised or have to refile amended tax returns.
- While relief was requested, and was provided to mutual fund trusts in December 20, 2006, tax reporters for dividends relating to other securities were not given relief.
- Without apparently considering the implications for tax reporting firms, the CRA also advised issuers that they could meet their requirements by a variety of means. While appreciating the CRA's efforts to try to facilitate dividend eligibility notification for issuers, the multiple alternatives offered made it extremely difficult for intermediaries and investors to find the issuers' dividend declarations – there are millions of press releases issued each year, internet search engines did not capture all possible reporting options and notification could occur *after* dividend payment had occurred **for 2006 tax reporting**, which made systems solutions even more challenging. By the end of February, there were only a handful of eligibility statements that could be found on the Internet. In answer to intermediary suggestions for the CRA to communicate to issuers directly, we were told that the CRA does not have a database of issuers that could have been used to communicate the recommendation to file early.
- After legislation requiring the reporting of dividend eligibility finally received Royal Assent in late February 2007, IIAC members continued to face challenges in getting required data. As an example, two major corporations refused to provide the information saying that they had given it to their transfer agent **and the transfer agents believed that they were prevented by client confidentiality requirements from releasing the information** to intermediaries.

CASE STUDY: T5013 FORMS

In 2006, the industry pressed for the revised T5013 form, which was known to be in revision and which was understood to be going from one to two forms and from a small number of boxes to over 100 floating boxes (we now know that the average amount of boxes completed by issuers for 2006 reporting was six of the 100+ possible floating boxes and the maximum, by a considerable amount, was one issuer that completed 15 of the boxes).

- In the last week of November 2006, the industry (having learned that the CRA had not finalized the forms) strongly advised the CRA against the change as the forms could be used as early as January 1, thus a smooth implementation in January 2007 was in any event impossible due to time constraints.
- In December, the CRA agreed to defer implementation for the intermediaries, and the intermediaries asked that this be made clear in tax booklets, etc. and that tax software providers be apprised.
- On or around January 31, 2007 – a month after the intermediaries had already received a small number of reports in the old, single-form format – the CRA posted, without notice, a T5013 and T5013A form on its website, without explanation, leading to issuer confusion and intermediary problems. Tax software providers were, it appears, not made aware that taxpayers could be receiving two types of T5013 forms – a 2004 version or one of two 2006 versions.
- The IIAC prepared communications to issuers and for intermediaries to use to advise clients. It is not clear what steps the CRA took to address the confusion.
- In February, the IIAC asked the CRA to confirm the changes to be made to the T5013 form as soon as possible as an income fund had already asked to use one for the 2007 year (for a wind-down filing), requesting in the strongest possible terms a return to a single form and asking again how the CRA benefits materially from two forms. No answer was received on this point.
- During July and August, the industry followed up with the CRA. IIAC Tax Reporting Committee representatives mocked up a single T5013 form with the CRA's desired multiple new fields and commented on the problems of the CRA's proposed forms, saying that:
 - An 8.5" x 11" size was much more cost-effective for intermediaries and that the CRA's proposed 8.5" x 14" form was impractical and would increase mailing costs
 - Wider margins ("white space") were needed for integrity marking – a requirement for copy quality in a high-speed printing environment
 - In the dynamic boxes, the labeling of 'Amount/Details' indicated that there could be both a dollar amount and a text description, adding programming complexity, both from the load of the data from CDS into the client site and for the assignment of values on the slip creation and that if there were to be a text description to accompany the value, it should be in a separate box
 - A single form would:
 - allow intermediaries to make the necessary systems changes most effectively (new specs to be fully reviewed, programmed, tested and implemented) earlier
 - reduce confusion for investors, issuers and e-filers

- better ensure investors receive their tax receipts on time to complete their personal income tax returns, avoiding the likelihood that they would submit incomplete information that would increase the amount of amendments filed with the CRA office
- promote more accurate reporting by issuers and intermediaries, reducing the likelihood of amendments and also saving the CRA and intermediaries administrative efforts and money
- give the CRA and tax reporting firms an opportunity to issue tax packages on a more timely basis, reducing the problems from the last tax season
- reduce the current total number of CRA forms by one, supporting CRA efforts and commitment to simplify reporting, especially for small businesses, where possible
- minimize paper use – taxpayers are voicing concerns with respect to unnecessary waste paper and its effect on our environment
- require less review, programming, integration and user acceptance testing, documentation and implementation by the CRA
- The guide would need to clarify what floating boxes were to be used for what sections – one example given was box 35 for income, where the guide stated that the income must be broken down by province or country source, but the static box 35 did not contain a province/country indicator, and the section of the form does not contain any floating boxes
- A firm answer from CRA was needed by August 15, certainly no later than August 31.
- The IIAC was advised only in September, and only informally, that the decision had been made to proceed with the two forms – we still would appreciate an understanding of why there are two forms. The CRA agreed to review the issue for the following tax year, however, at this stage further costs would be incurred to reverse the process.

**EXTRACTS FROM CRA COMMITMENTS TO TAXPAYERS
AND SMALL BUSINESSES**

Taxpayer Bill of Rights

6. ... the right to complete, accurate, clear, and timely information
10. ... the right to have the costs of compliance taken into account when administering tax legislation
12. ... the right to relief from penalties and interest under tax legislation because of extraordinary circumstances.
13. ...the right to expect us to publish our service standards and report annually.

The Canada Revenue Agency Commitment to Small Business

1. The CRA is committed to administering the tax system in a way that minimizes the costs of compliance for small businesses.
2. The CRA is committed to working with all governments to streamline service, minimize cost, and reduce the compliance burden [the administrative and paper burden on small businesses to assist them to become more competitive].