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August 28, 2025

Department of Finance Canada
90 Elgin Street
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**Via email:** yourbudget-votrebudget@fin.gc.ca

**RE: TEI Recommendations for Pre-Budget Consultation and Tax Reform**

Dear Sir or Madam:

In its campaign platform, the Liberal Party of Canada pledged to "conduct an expert review of the corporate tax system based on the principles of fairness, transparency, simplicity, sustainability, and competitiveness." Tax Executives Institute, Inc. ("TEI") agrees there should be a review of the corporate tax system, which is long overdue. In this regard, we group our comments in this letter into three broad categories: (i) the overall simplicity of the corporate tax system; (ii) changes to the Canada Revenue Agency's ("CRA") approach to audits and dispute resolution; and (iii) the complexity of Canada's foreign affiliate system.

**About TEI**

TEI was founded in 1944 to serve the professional needs of in-house tax professionals.[1] Today, the organization has 55 chapters across North and South America, Europe the Middle East & Africa ("EMEA"), and Asia, including four chapters in Canada. Our over 6,000 members represent 2,800 of the world's leading companies, many of which either are resident or do business in Canada. Over 15% of TEI's membership comprises tax professionals who work for Canadian businesses in a variety of industries across the country. The following comments and recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

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[1] TEI is organized under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

**TEI Comments**

Simplicity of the Corporate Tax System

Compliance with the Income Tax Act ("ITA") has become increasingly difficult over the past several years due to the complicated, excessively broad, and often duplicative nature of new tax legislation. This significant growth in compliance obligations does not provide any material return for the CRA. Overall, compliance obligations for Canadian corporate taxpayers have gotten out of hand. Eventually, large and small corporate taxpayers will find themselves unable to meet all the demands of increasingly complex tax legislation.

In line with the current government's campaign platform, TEI supports reviewing tax legislation in Canada for compliance simplification, consolidating filing requirements, as well as simplification of both legislation and the appeals process.

*Compliance Simplification*

Additional current (and future) tax compliance workload examples include:

(i) Increased reporting on T1134 forms;

(ii) Country-by-Country Reporting ("CbCR");

(iii) Mandatory disclosure reporting;

(iv) EIFEL reporting;

(v) The Global Minimum Tax Act;

(vi) The Underused Housing Tax;

(vii) Bare Trust reporting; and

(viii) Reporting fees for services.

This increased reporting and compliance workload is due to two factors. First, in our view the Department of Finance ("Finance") does not give due consideration to reporting obligations introduced in new tax legislation. The bare trust reporting rules, for example, created an "unintended impact on Canadians"[2] and led to two years of administrative relief from reporting because Finance and the CRA could not delineate what constitute a "bare trust." TEI members therefore reported thousands of bare trust arrangements, a costly – and wasteful – effort.

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[2] *See* https://www.canada.ca/en/taxpayers-ombudsperson/programs/reports-publications/special-reports/unintended-consequences-bare-trusts.html.

Second, the CRA does not generally consider the reporting burden placed on taxpayers when it implements and enforces new legislation. Indeed, the CRA has expanded reporting content in many new forms so taxpayers do the work the CRA would otherwise do on audit. For example, new Schedule T130 for reporting taxpayer compliance with the EIFEL rules, is 14 pages long and requires multiple supporting forms and elections just to compute a single number contributing to net taxable income. This results from complex legislation supported by unreasonable and unnecessary reporting obligations. The CRA almost entirely ignored TEI's previous concerns with the complexity of these forms. Another example is the expanded T1134 forms with shortened deadlines. The added compliance burden on taxpayers appears to have little demonstrable connection to any meaningful increase in fiscal revenue.

We have also raised serious concerns about the reporting level required under the mandatory disclosure rules. The CRA responded that it wanted to see the filings before considering any changes. This is an example of the backward approach the CRA takes when it develops compliance policy. Rather than ask for everything, the CRA should prioritize simplicity. Since the CRA released the forms, it has taken no action to simplify or streamline reporting under these rules.

In addition to the increased reporting workload, much of the reporting required of taxpayers is duplicative. For example, taxpayers affiliated with non-Canadian entities must file T106s, T1134s, a country-by country report, and then a completely different return under the Global Minimum Tax Act. Surely these obligations can be combined into a more efficient report that relieves the burden on both the preparers (taxpayers) and the reviewers (CRA). The T106 and T1134 could easily be combined, for example.

Similarly, much reporting under the ITA is unnecessary. Affiliated companies within a related group must still file T5 returns and slips reporting dividends and interest paid between them. This information serves no meaningful purpose to either taxpayers or the CRA. In addition, many schedules within the T2 require duplicative information in slightly different ways that could be efficiently merged (Schedules 9, 19 and 50, for example). The T2 return also includes numerous schedules requiring low-value information otherwise contained within financial data produced on audit (Schedules 11 and 14, for example). Gathering this information consumes taxpayer time and resources. Moreover, CRA rarely questions the information on audit and yet often requests the same information in another fashion (e.g., instead of Schedules 9, 19 and 50, auditors ask for organizational charts).

Taxpayers must also complete Schedules 25 and 29 which duplicate information provided in the T1134, T106, T4A-NR and NR4 filings.

Moreover, TEI recommends Canada harmonize income tax compliance with all provinces. Many forms with the same information must be filed with the CRA, Quebec and Alberta. This duplicate filing is completely unnecessary.

TEI has repeatedly commented to the CRA and Finance that the compliance burden associated with new legislation is disproportionate, unnecessary, and duplicative. We often hear from the CRA that it is enforcing the legislation as written and from Finance that it is responding to the CRA's information desires. This leaves the taxpayer in the middle to figure out how to comply. TEI requests Finance embark on a consultation process that seeks to alleviate the ever-increasing compliance burdens on taxpayers while still providing CRA with the information it requires to assess and audit taxpayers. TEI would be pleased to assist in this project.

*Consolidated Filings*

Canada's lack of a consolidation regime is out of step with other countries' tax systems. Many of Canada's largest trading partners, including the United States, the United Kingdom, and Australia, employ some form of tax consolidation regime whereby filing is summarized and consolidated, losses are transferable, and/or transactions within the group are ignored. Canada's lack of a consolidation regime requires affiliated taxpayers to follow almost all the same rules they follow in dealing with unrelated parties. Examples include the:

(i) Need for subsection 85(1) and similar rollover elections in wholly owned groups;

(ii) Requirement to allocate Part VI.1 tax to related parties to ensure that the deduction can be used;

(iii) Complicated reorganizations to transfer losses to a related entity;

(iv) Extremely complicated EIFEL rules, which contain a complex system whereby interest deductions are allocated amongst related taxpayers to ensure that the group can obtain the interest deductions to which it is entitled; and

(v) Notion that dividends above "safe income" for a particular subsidiary within a consolidated group could trigger a capital gain where no sale has taken place and where the group has the necessary tax-paid retained earnings to pay a dividend to its ultimate parent or the public.

The current system is outdated. In 2010, Finance engaged taxpayers in a discussion of possible consolidated reporting. As with prior initiatives on the topic, the discussion did not progress because of a lack of agreement among the provinces on how revenues would be shared. It is time to re-visit this issue and find a solution. Because the EIFEL rules allow interest deduction transfers between taxpayers without considering provincial jurisdiction means losses are already being effectively transferred within related groups. In line with the government's pledge to remove interprovincial trade barriers and to respond to tariff threats from the United States, Finance must find a solution whereby provinces cooperate to allow consolidated taxation across Canada.

*Legislative Simplification*

In line with above comments, TEI encourages the government to conduct a comprehensive review of the ITA to identify overly complex regimes and simplify them. We set forth examples below.

***Simplified Depreciation***

The capital cost allowance ("CCA") rates have always contained a mixture of tax policy (encouraging spending in certain sectors) and an estimate of an asset's expected useful life. As a result, there are too many CCA classes with too many rates. Simplying and merging CCA classes would reduce the compliance and administrative burden on taxpayers and the CRA, respectively.

***Elimination of Duplicative Legislation***

Many of the recent additions to tax legislation have overlapped existing legislation. For example, the EIFEL rules have rendered the thin capitalization rules under subsection 18(4) unnecessary. Entities not large enough to be subject to the EIFEL rules should also be outside the scope of interest deductibility limits, reducing the compliance burden on such taxpayers.

***The EIFEL Regime***

The recently enacted EIFEL legislation is overly complex. Adjusting to this legislation has greatly increased the compliance burden for taxpayers already struggling to meet filing deadlines. As just one example, the method for determining non-deductible interest should be simplified.

The above are just a few examples of where the ITA could be streamlined without jeopardizing government revenues or impacting fairness and transparency. Further comments on the foreign affiliate regime in particular are below. TEI would again be pleased to participate with Finance in a project that seeks to simplify the ITA.

Improving and Expediting the Audit Process

We understand that it should be a government priority to improve "the efficiency and effectiveness of tax audits." TEI heartily agrees. However, as we noted last year in our submission on proposed new CRA audit powers and penalties contained in the 2024 Federal Budget, any efforts to enhance "the efficiency and effectiveness of tax audits" cannot merely involve providing CRA with more powers or additional resources as CRA does not make full use of its current resources.[3]

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[3] Please see our submission dated May 29, 2024 at: https://www.tei.org/advocacy/submissions/canadian-budget-2024-expanded-cra-audit-powers-tei-comments.

Improving audit quality and the dispute resolution process is critical to improving the efficiency and effectiveness of tax audits.

*Audit Quality*

Taxpayers have long had concerns about the quality of CRA audits resulting in technically weak or unfounded reassessments.[4] As the Auditor General reported in 2016, almost two-thirds of objections were decided in favour of taxpayers by the CRA Appeals branch ("CRA Appeals"), with 42% of all objections decided fully in favour of taxpayers.[5] Consequently, CRA Appeals reversed more than 50% of CRA assessments, measured by dollar value.[6] Further, while these amounts are not tracked, the Tax Court of Canada ("TCC") subsequently reversed some additional portion of the assessments which were upheld at Appeals. Moreover, despite significant increases in CRA resources, it does not appear that matters have much improved over the past decade. Recent reports for 2024/25, indicate that 62% of all objections across CRA programs were resolved in favour of taxpayers.[7] Reassessments which are not technically sound, and which prove to be unfounded on appeal, are a drain on taxpayers and divert CRA resources from better uses. Such reversals undermine public confidence in the fairness and integrity of the tax system

Better training, particularly for auditors dealing with large corporate taxpayers subject to highly technical rules, would help avoid ill-founded reassessments. Ideally, auditors would be familiar not just with the technical rules relevant to a particular taxpayer and their industry, but also with the conduct of business in that industry and its common practices. Such expertise will improve audit quality and expedite the audit process. Audit queries would be better focused, both on the relevant technical issues, and, consistent with CRA's own policy, on the smaller subset of information necessary to explain a taxpayer's filing position, rather than voluminous, duplicative material that may be used to support weak alternative positions.[8]

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4 *See, e.g.*, Michelle Shriver, "Addressing Technically Weak Tax Assessments" *Investment Executive*, June 1, 2025, *available at*: https://www.investmentexecutive.com/newspaper_/news-newspaper/addressing-technically-weak-tax-assessments/

5 *2016 Fall Reports of the Auditor General of Canada – Report 2 Income Tax Objections – Canada Revenue Agency* at paras. 2.67 and 2.72. available at: *https://www.oag-bvg.gc.ca/internet/English/parl_oag_201611_02_e_41831.html.*

6 *Ibid*, at para. 2.72.

7 *Supra*, note **Error! Bookmark not defined.**.

8 CRA Policy Document #AD-19-02R – Obtaining Information for Audit Purposes, available at: https://www.canada.ca/en/revenue-agency/services/tax/technical-information/compliance-manualspolicies/acquiring-information-taxpayers-registrants-third-parties.html.

In addition, reassessments with complex issues and/or large dollar amounts should go through quality control at the CRA Head Office. As part of this process, taxpayers should be able to make representations directly to Head Office on both the facts and the law to ensure that the CRA has sufficient basis for making the reassessment.

Finally, greater collaboration with taxpayers should be encouraged. While taxpayers and the CRA inevitably may have somewhat of an adversarial relationship, both have a common interest in efficiently resolving audits. Further, taxpayers are uniquely positioned to explain their business and to assist in determining what data might help support their tax reporting or address the CRA's requirements. While the CRA is, of course, entitled to ask for the information necessary to do its job effectively, both parties will greatly benefit from early identification and determination of relevant information.[9]

*Resolving Audit Related Disputes*

An obvious bottleneck in the audit process lies in the lack of a timely process for resolving audit disputes between the CRA and taxpayers. At present, taxpayers have no effective or judicious means to resolve audit disputes with the CRA – their only recourse is either to seek judicial review of the CRA's actions in the Federal Court of Canada (the "Federal Court"), which delays such audits, but typically does not provide for a substantive resolution of the dispute (since judicial review merely reviews the reasonableness of the CRA's decision, not the correctness of the taxpayer's position),[10] or to wait for the CRA to pursue a compliance order at the Federal Court. In practice, either option can take years to resolve. Such delays frustrate taxpayers and CRA alike and provide opportunities for bad actors to delay and undermine legitimate CRA audit activity.

To be clear, this is not to place blame on the Federal Court. Many of the points we make, in greater detail with respect to the TCC below, apply equally to the Federal Court. The resources of the Federal Court have not increased over the past decade, while the resources of the CRA, and consequently the number of audits, and Canada's population, thus the number of disputes within court's broad jurisdiction, have increased significantly. As a result, the Federal Court simply does

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9 This point was recently emphasized by the Federal Court in *Canada (National Revenue) v. Shopify Inc.* (2025 FC 969), where the court observed that the problems with the requirement at issue "could have perhaps been avoided had the Minister chosen to genuinely collaborate with Shopify on this UPR request, and tailor its terminology in a way consistent with a shared and reasonable understanding between both parties—even if the Minister had no strict obligation to do so."

10 The limited jurisdiction of the federal court leads to potentially duplicative and inconsistent litigation. See, for example, *Canada (National Revenue) v. Zeifmans LLP*, 2023 FC 1000 where the CRA's decision was upheld as reasonable by the federal court in judicial review proceedings, but incorrect when the CRA sought a compliance order at the Federal Court.

not have the capacity to deal with audit related tax disputes in a timely fashion. To make the obvious point, no audit can proceed expeditiously if it takes years to resolve disputes over the validity of CRA information requirements or queries issued to start, or during, those audits.

TEI has previously made several suggestions to expedite the resolution of audit disputes between taxpayers and CRA, including:

(i) Provide more and better training to CRA auditors.

(ii) Encourage more focused demands for information in queries and requirements.

(iii) Promote better collaboration with taxpayers during audits.

(iv) Provide additional resources to the Federal Court including, as necessary, appointing more judges.

(v) Working with the Federal Court to create a "tax list" – similar to the "commercial list" in Ontario's Superior Court – of specialized judges tasked with dealing with tax disputes on an expedited basis.

(vi) Alternatively, and preferably, amending the Tax Court of Canada Act to move jurisdiction to hear tax disputes relating to audits to the specialized TCC from the generalist Federal Court and provide commensurate resources for the TCC to resolve these cases in a timely fashion. Canada has a specialized tax court; it makes sense to give it responsibility for all (civil) tax related disputes.

(vii) Create a statutory right for both taxpayers and CRA to seek judicial determination as to the nature of a taxpayer's compliance obligation vis-à-vis a particular requirement/audit query on a correctness standard, instead of relying on either (a) the existing right to seek judicial review of the reasonableness of the Minister's decision to issue requirements/queries or (b) compliance proceedings.

(viii) Reconsider the proposed new audit powers and penalty proposals contained in the 2024 Federal Budget. As we noted in our prior submission, many of those proposals, which heavily rely on the Federal Courts to oversee, instead of expediting audits, will only further strain an already overburdened court system, resulting in greater delays and undermining the efficacy of the audit process.

Adopting these proposals will advance the audit process in three material ways. First, audits will be more efficient. Second, the resolution of genuine disputes between taxpayers and the CRA will be expedited. And third, expeditious dispute resolution will discourage malicious actors from using such disputes to drag out and delay audits.

Expediting the Resolution of Disputed Assessments

*Delays Resolving Appeals*

A consistent taxpayer complaint is the lengthy delays resolving even relatively simple tax disputes arising from CRA audits. Over the past decade, the CRA has received significantly more resources and been given a mandate to audit more Canadians to bring in tax revenue. Consequently, taxpayers are faced with more, and more complex, disputes. Unfortunately, there has not been a matching increase in the resources provided to CRA Appeals or the TCC, the institutions charged with resolving those disputes. As a result, even relatively straight-forward disputes can take years to resolve, while the timeline for resolving more complex disputes is regularly measured in decades.

CRA Appeals routinely fails to meet its own service standards. Currently, CRA commits to resolving 80% of "low-complexity" and "medium-complexity" objections within 180 and 365 days, respectively. In 2023-24 (the last year for which data is available), the CRA resolved objections within those timelines 61% and 69% of the time.[11] Further, and of more relevance to TEI members, there is no standard for high-complexity cases, and it is common for years to pass before appeals officers are even assigned to such matters.[12] Under the ITA, taxpayers have a right to appeal to the TCC if their objections have not been disposed of within 90 days of filing a notice of objection, which suggests that the CRA's current service level standards, even for low-complexity objections, take far longer than Parliament had contemplated.[13]

Similarly, disputes advancing to the TCC (whether after an unsuccessful resolution of such disputes at CRA Appeals or, given the lengthy delays at CRA Appeals, as an alternative to resolving disputes at CRA Appeals), often take years, or even decades, to resolve. Notwithstanding the increase to CRA resources over the past decade, the number of TCC judges has decreased since 2015.[14] If nothing else, addressing population growth alone would have justified adding two or three new judges to the TCC. Moreover, the mere number of judges understates the TCC crisis. For one

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11 Service Standards 2023-2024, available at: https://www.canada.ca/en/revenue-agency/services/about-canada-revenue-agency-cra/service-standards-cra/service-standards-2023-24.html.

12 *Ibid*.

13 Subsection 169(1) of the ITA.

14 There were 27 judges sitting in the TCC as of July 2015. As of June 2025 are currently 26 judges sitting in the TCC (https://web.archive.org/web/20150818003954/https://www.fja.gc.ca/appointments-nominations/judges-juges-eng.aspx and https://www.fja.gc.ca/appointments-nominations/judges-juges-eng.aspx). Although less visible to our members, we understand that there has been a lack of resources for the Department of Justice as well, which the Government has only recently started to address. It goes without saying that our comments with respect to the need for adequate resources for the TCC apply equally to government departments whose participation is required for the efficient resolution of such disputes.

thing, the TCC was closed for several months during COVID (and operated at a reduced capacity once it started hearing cases again), resulting in the loss of hundreds of "sitting weeks" and delaying thousands of pre-existing cases. Further, due to delays in appointing new judges, the TCC is operating well below its nominal capacity.[15] In addition, Chief Justices of the TCC have long lamented the lack of resources for technology and administration to make the TCC more efficient.

Finally, a consistent taxpayer complaint is the persistent, lengthy delays in finalizing the resolution of tax disputes after a final decision from CRA Appeals or the TCC. Often it takes years for the CRA to give effect to such final determinations. Moreover, the CRA is often slow to resolve disputes relating to other taxation years on the basis of such decisions (e.g., if an issue is resolved in one way for one taxation year, absent some distinguishing characteristic, one would expect it to be resolved in a consistent manner for subsequent years). Such delays cause taxpayers both undue hardship and unfairness and create a lack of predictability, which is contrary to good tax administration.

*Delays Undermine Productivity and Fairness*

The current situation is untenable. Long, drawn-out tax disputes represent a drain on the productivity of Canadian businesses – a longstanding issue the government has committed to address.[16] Tax disputes tie up capital, divert internal resources from more productive uses, and create uncertainty, all of which discourage investment and growth. Overall, prolonged and unnecessary tax disputes can undermine Canada's economy.

Extended tax disputes are also unfair to taxpayers as delay in court proceedings creates prejudice. In the tax system, the taxpayer bears that prejudice because the taxpayer must rebut CRA assessments (or reassessments). The passage of time can lead to fading memories, the loss of witnesses (as employees move or retire), and the loss of relevant evidence.[17] As the Government noted in its 2024 Budget, citing the Carter Commission, "fairness should be the foremost objective of the tax system." Delays create unfairness to taxpayers and must be addressed.

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15 While we acknowledge that many of those vacancies have been filled recently, we understand that the newly appointed judges are still undergoing training, so have not yet brought TCC up to functional full capacity. Furthermore, those judges will then have to deal with the backlog created by prior unfilled vacancies.

16 See, for example, the Mandate Letter published by Prime Minister Carney on May 21, 2025: https://www.pm.gc.ca/en/mandate-letters/2025/05/21/mandate-letter.

17 This latter point is particularly troubling, given that the CRA is often allowed to introduce new arguments very late in the litigation process.

*Recommendations to Reduce Delays*

Tax disputes are inevitable in a self-assessment tax system. Long delays in resolving disputes are not. Expeditious resolution is a core component to sound tax administration because it provides certainty and improves taxpayer compliance. To help remedy the inherent delays, we offer the following proposals to expedite and incentivize the prompt resolution of tax disputes:

(i) Increase resources for CRA Appeals, to ensure that appeals are addressed in a timely fashion: This should be a priority because resolving disputes at CRA Appeals is generally less costly and faster than resolving disputes in court, for both the CRA and taxpayers. Moreover, for individuals and small businesses, where the amounts at issue are often modest, CRA Appeals may be the only meaningful venue to resolve disputes, given the cost and complexity of litigating disputes in the TCC.

(ii) Appoint additional TCC judges and provide the TCC with the resources necessary to eliminate its case backlog and resolve current cases in a timely fashion: The availability of judges and sufficient courtroom resources should not be a barrier to timely tax dispute resolution. The government should provide the TCC enough resources to eliminate the current case backlog and provide additional future resources so the TCC can continue to grow in proportion to CRA dispute activity.

(iii) Eliminate the "large corporation" rule that compels large taxpayers to remit 50% of disputed reassessments: This rule creates an undue burden on Canadian businesses and ties up capital which could be better used by Canadian businesses. It also creates – or at least is perceived as creating – an incentive for the Minister to issue large, if technically weak, reassessments to generate revenue. There is no compelling policy rationale for this punitive treatment of Canadian businesses. Eliminating this rule would encourage the CRA to resolve disputes as there would be no additional revenue to the Canadian fisc until such resolution.

(iv) Equalize interest rates on arrears and refunds: The current interest rate regime rewards the CRA for lengthy delays in resolving disputes because it can be considered a revenue source. If the CRA succeeds, it collects interest from corporate taxpayers at a rate much greater than its cost of capital. Conversely, the regime penalizes taxpayers because if a taxpayer is successful in its refund claim, the arrears interest rate is typically substantially lower than its cost of capital. While a punitive interest rate on unpaid taxes may be reasonable where there is no genuine dispute in respect of whether such taxes are owed, at the very least, interest should be equalized in respect of amounts that are under objection or appeal, to put taxpayers and the minister on a level playing field.[18]

(v) Create clear timelines and incentives for the CRA to pay refunds following the final resolution of a dispute: Just as the CRA expects taxpayers to pay amounts owed in a timely fashion, the CRA should pay refunds for successful taxpayer appeals in a timely fashion and should establish clear timelines for giving effect to such appeals.

(vi) Assign jurisdiction of all (civil) tax matters to the TCC: As discussed above with respect to audit disputes, Canada specialist tax court should have jurisdiction over all (civil) tax disputes.

(vii) Account for successful appeals: Consistent with prior recommendations of the auditor general,[19] the government should account for the likelihood that some portion of the tax it assesses will ultimately not be payable when reporting its finances. The failure to account for successful taxpayer challenges overstates the CRA's "tax gap" computation and the CRA's apparent success in closing the gap (i.e., an unfounded reassessment results in an increase in the reported tax gap and offsetting increases in the CRA's success in closing it). Such a failure also undermines the integrity of Canada's public finances by overstating government revenue. Requiring the government to account for successful challenges would provide both a more accurate picture of the government's finances and the performance of its tax collection agency.

(viii) Discourage weak or "long-shot" CRA arguments": A repeated complaint expressed by taxpayers – one that has been recognized by the Courts in cost awards – is that the CRA pursues meritless grounds for reassessment that are unlikely to succeed (asserting a taxpayer's structure is a "sham" is an example). While such arguments are unlikely to succeed, they force taxpayers to devote considerable resources to refute them – because, again, in the TCC the onus lies taxpayers to refute the CRA's assessments – delaying resolution of the substantive dispute, tying up significant government and taxpayer resources, and giving rise to enormous costs. While the TCC has started to respond to these circumstances by granting significant cost awards

[18] We acknowledge this might incentivize bad actors to bring frivolous appeals to reduce the cost of their unpaid taxes. We would suggest that such behaviour could be discouraged by permitting the imposition of retroactive "punitive" interest in cases where appeals are frivolous or not pursued in a timely fashion.

[19] 2018 Fall Reports of the Auditor General of Canada – Report 7 – Compliance Activities – Canada Revenue Agency at para 7.87, available at: https://www.oag-bvg.gc.ca/internet/English/parl_oag_201811_07_e_43205.html#p87.

against the CRA, it would be preferable for all concerned if the CRA simply didn't advance such "long-shot" arguments in the first place.

Simplifying Canada's Foreign Affiliate Regime

Canada's foreign affiliate regime plays a vital role in protecting the Canadian tax base from offshore deferral. However, the system has grown increasingly complex and burdensome, both for taxpayers and tax administrators. Reform is needed to modernize and streamline what has become a patchwork regime in a manner aligning with international norms while ensuring adequate protection of the Canadian tax base. Reform of the regime should strike the right balance among competitiveness, simplicity, and tax integrity.

In this section we express our key concerns with the current regime in three principal areas: (i) taxation of dividends from controlled foreign corporations ("CFCs"); (ii) taxation of passive income earned by CFCs; and (iii) the need to eliminate redundant and overlapping legislative provisions. These changes will reduce compliance burdens, support international competitiveness, and refocus Canada's tax policy on its core objectives in a modern global economy without a significant reduction to the Canadian tax base.

*Taxation of CFC Dividends*

Canada's current system for taxing dividends from CFCs is an unnecessarily complex hybrid of an exemption and credit model. While the system functions as a de facto exemption system for many non-portfolio dividends, it retains the legislative and administrative architecture of a credit regime. This duplicative structure leads to disproportionately high compliance costs with negligible fiscal benefits to the government.

The existing regime imposes a significant administrative burden on both Canadian multinational enterprises and the CRA. Chief among these inefficiencies is the foreign affiliate surplus regime, which requires taxpayers to track notional income pools—such as exempt surplus, taxable surplus, and hybrid surplus—on an entity-by-entity basis. Taxpayers must also monitor foreign tax payments, upstream loans, and various elections, which add layers of compliance complexity even in routine commercial operations.

The original surplus regime designed to allow an exemption system to apply to active income earned in treaty countries (presumed "high tax") and a credit system to all other income is now outdated. Today, the exemption system frequently applies to affiliates in low-tax jurisdictions, and its utility in promoting tax information exchange agreements has largely diminished. Moreover, global tax coordination efforts—particularly the OECD's Base Erosion and Profit Shifting ("BEPS") initiative and the implementation of the Pillar Two global minimum tax—have significantly curtailed tax arbitrage opportunities. Additionally, taxpayers often choose not to repatriate low-taxed surplus, resulting in neither an enhancement of the Canadian tax base nor an increase in capital reinvestment in Canada. These developments undermine the original justification for maintaining the surplus regime in its current form.

TEI recommends Canada adopt a streamlined participation exemption regime for non-portfolio dividends—i.e., dividends received from foreign corporations in which the Canadian parent owns a significant equity interest (e.g., at least 10%). Implementing such a regime would enable the repeal of much of the surplus tracking framework, thus substantially reducing compliance and administrative burdens without jeopardizing the integrity of the Canadian tax base.

Our recommended approach is consistent with international best practices. Most G7 and OECD member countries utilize a participation exemption model for dividends from substantial shareholdings. These systems operate without the need for surplus pool tracking or complex elections, making them more administratively efficient and transparent. A similar move by Canada would improve the investment climate, encourage the repatriation of foreign earnings, and reallocate valuable compliance resources to more productive economic activities. The legislative models adopted by our contemporaries, such as the United Kingdom, could serve as a guide, obviating the need to design a new system from scratch. Additionally, Canada could consider extending participation exemption treatment to capital gains on the sale of shares in foreign affiliates—again, in line with practices in other jurisdictions.

*Taxation of CFC Passive Income*

Canada's foreign accrual property income ("FAPI") regime is grounded in the important policy objective of preventing base erosion via offshore vehicles that earn lightly-taxed passive or easily shiftable income. That said, Canada's rules are an outlier among G7 countries in that Canada applies these rules globally, regardless of the jurisdiction in which the foreign affiliate operates or the tax rate imposed there.

Most G7 countries—including the United States, United Kingdom, and France—limit their CFC regimes to low-tax jurisdictions or low-taxed income. Canada's all-jurisdictions approach imposes significant compliance burdens on taxpayers operating in high-tax jurisdictions, even where there is obviously no risk of tax deferral or base erosion. This is out of step with international practice and places Canadian businesses at a competitive disadvantage.

While a global regime may be theoretically sound, in practice it demands extensive documentation, reporting, and calculations from taxpayers, with limited incremental benefit to government revenues. For example, at present, a taxpayer is required to file in respect of each CFC a 13-page information form referred to as a T1134 (often in duplicate form where the CFC is held by multiple Canadian entities in a year). Hundreds of thousands of these forms are sent annually both in electronic form and by mail, which CRA is then required to process. It's difficult to see the benefit these forms are providing when weighed against the administrative cost both on the side of the government and the taxpayer.

A more streamlined and targeted approach—such as focusing on low-tax jurisdictions or low-taxed income using an effective tax rate test—will achieve the same anti-deferral goals while significantly easing compliance burdens and reducing administrative complexity. A tailored approach also presents minimal risk, as Canada's largest taxpayers are already subject to Pillar Two, which ensures low-taxed income is brought up to a minimum 15% rate under the IRR regime. In addition, narrowing the scope and volume of foreign affiliate reporting would allow both the CRA and taxpayers to allocate resources more effectively.

In the absence of a comprehensive reform, a targeted review of the current system should be undertaken to enhance clarity and reduce complexity. One meaningful step would be the introduction of a consolidation framework that permits transactions between entities within the same foreign jurisdiction to be disregarded for the purpose of calculating FAPI. Such measures would reduce the administrative burden, eliminate artificial income inclusions, and better reflect the economic reality of integrated business operations conducted through multiple affiliates in a single country. Another welcome change on the administrative front would be to exempt entities filing under the GMTA from also filing T1134s or at least provide for a reduced reporting requirement. Since the GMTA already requires extensive disclosure, duplicating this through T1134s imposes significant costs on both taxpayers and the CRA with only limited incremental tax benefit. A more targeted and efficient approach could be for the CRA to leverage Global Information Return data to identify low-tax jurisdictions with meaningful revenues and focus audit queries accordingly. This would allow the CRA to address FAPI risks effectively without imposing redundant reporting obligations.

*Removing Redundant Legislation*

Canada's international tax framework has accumulated layers of anti-avoidance provisions, many of which overlap and contribute to excessive complexity. As the Finance undertakes broader reform initiatives in the name of simplicity, we urge it to examine opportunities to remove or streamline redundant regimes.

The foreign affiliate dumping ("FAD") rules are a prime example. These provisions are highly complex and include many interpretive pitfalls for taxpayers. One of the main policy objectives behind the FAD rules—limiting the use of excessive interest deductions in foreign-owned Canadian groups—has now been significantly addressed by the introduction of the EIFEL rules.

The co-existence of the FAD, EIFEL, and thin capitalization regimes results in three overlapping interest limitation frameworks, all broadly targeting the same concern: limiting base erosion through debt. This redundancy imposes undue compliance burdens on taxpayers who must navigate and reconcile different rule sets, tests, and thresholds. It also complicates administration and enforcement for the CRA.

We recommend Finance review these regimes for consolidation and elimination of overlap, giving serious consideration to repealing or significantly narrowing the scope of the FAD rules and revisiting the continued need for thin capitalization rules in their current form.

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TEI appreciates the opportunity to provide our comments on Canada's corporate tax system. We would also welcome an invitation to further discuss our concerns and recommendations, and to collaborate to solve the challenges presented by the current structure and craft an improved system. Please do not hesitate to contact Sandy Shanks, Chair of TEI's Canadian Income Tax Committee, at sandy.shanks@conocophillips.com, or Benjamin R. Shreck of TEI's legal staff at bshreck@tei.org or +1 202 464 8353 with any questions.

Respectfully submitted,

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